

Service Date: November 23, 1992

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

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IN THE MATTER of the Application	)	UTILITY DIVISION
of U S WEST Communications for	)	
Authority to Implement a Montana	)	DOCKET NO. 90.12.86
Network Improvement and Rate	)	ORDER NO. 5535g
Stability Plan.	)	

In the Matter of the Application	)	DOCKET NO. 89.8.28
of U S WEST Communications for	)	
Authority to Offer Dual Service	)	
as a Service Product.	)	

In the Matter of the Application	)	DOCKET NO. 89.8.35
of U S WEST Communications for	)	
Authority to add Integrated	)	
Services Digital Network to its	)	
Montana Tariff.	)	

In the Matter of the Application	)	DOCKET NO. 89.9.29
of U S WEST Communications for	)	
the Addition of Six New Custom	)	
Calling Features [Open Network	)	
Architecture (ONA)].	)	

In the Matter of the Application	)	DOCKET NO. 90.5.32
of U S WEST Communications for	)	
Authority to Add Digital Switched	)	
Services to its Montana Tariff.	)	

FINAL ORDER

APPEARANCES

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BEFORE:

Danny Oberg, Chairman  
Wallace W. "Wally" Mercer, Vice Chairman  
Bob Anderson, Commissioner  
John B. Driscoll, Commissioner  
Ted C. Macy, Commissioner

FINDINGS OF FACT: BACKGROUND

1. On December 14, 1990, U S WEST Communications (USWC, Applicant, Company) filed an application for authority to implement a Montana Network Improvement and Rate Stability Plan. The Company explained that it would make a \$91 million commitment to upgrade 114 electromechanical switches to digital switching if the Company was given the opportunity to improve its earnings through a combination of expense controls and increased sales. Mr. Ruff, the Montana Vice President and Chief Executive Officer for USWC, summarized the key points of the Rate Stability Plan:

- 1) Rates for basic services would generally be frozen for five years;
- 2) a fixed range of returns -- from 11.0 to 12.5 percent on rate base -- would be set as target levels in which USWC would expect to operate under normal conditions for the next several years;
- 3) profits above the range would be shared 50-50 between customers and the Company;
- 4) prices for non-basic services could be changed more easily to meet competitive and marketplace needs.

USWC also made a financial showing in this Docket. The Company did not request additional revenues but did make a showing that additional revenues in the amount of \$8.1 million would be needed to recover expenses and to earn a fair rate of return. USWC did not request higher rates because the Company recognized that the Montana Public Service Commission (Commission, PSC) and the Montana Consumer Counsel (MCC) had in past rate cases contested a number of the issues contained in the financial showing. The Company reaffirmed its earlier proposal to freeze rates for basic exchange services. However, the Company did propose to increase and decrease other rates for optional services to bring prices closer to costs or market conditions.

2. On December 21, 1990, the Commission issued Order No. 5535 which granted USWC's request for a protective order.

3. On March 21, 1991, the Commission issued Order No. 5535a which was a procedural order. The Commission had previously issued interim orders in the following USWC Dockets:

Docket No.	Order No.	Order Date
89.8.28	5424	9/29/89
89.8.35	5468	3/27/90
89.9.29	5467	3/27/90
90.5.32	5477	6/05/90

Each of the above interim orders stated that the Docket would be consolidated into the next USWC general rate case. Pursuant to ARM 38.2.3911 and the above Orders the Commission consolidated Docket Nos. 89.8.28, 89.8.35, 89.9.29 and 90.5.32 into Docket No. 90.12.86. The Commission stated that previously approved forbearance applications would be examined to ensure that discount prices did not fall below the Commission's estimate of relevant marginal costs.

4. On April 30, 1991, USWC filed the amended testimony of Ms. Keiter.

5. On May 2, 1991, the Commission granted intervention to the following parties: AT&T, Department of Administration, GTE Northwest Inc., MCI, MCC, Northwestern Telephone Systems, Inc., TECOM, and Telecommunications Resources, Inc. On

December 30, 1991, the Commission issued Order No. 5535e which granted late intervention to the Pacific Northwest Newspaper Association.

6. On June 12, 1991, the Commission issued Order No. 5535b, which was an amendment to the protective order. The requirement that proprietary information shall be returned by all parties to USWC within 30 days after final settlement or conclusion of this proceeding was added. This requirement does not apply to the Commission or the MCC.

7. On July 15, 1991, USWC filed revisions to the revenue requirement. USWC's witness Mr. Brian Johnson indicated that there were seven updates to the revenue requirement:

- 1) Changes in allocations.
- 2) Updates in the overall cost of capital.
- 3) Removal of aerial wire costs.
- 4) New depreciation lives.
- 5) Changes in the Telephone License Tax.
- 6) Savings from Service Link integration.
- 7) Other Post Employment Benefit (OPEB) costs to include retired employees.

The net effect of these changes was an increase in the revenue requirement of \$9,000.

8. On September 12, 1991, AT&T filed the direct testimony of its witnesses Ms. Brightwell and Dr. Zahn.

9. On September 12, 1991, MCI filed the direct testimony of its witness Mr. DiTirro.

10. On September 13, 1991, MCC filed the direct testimony of its witnesses Dr. Wilson, Dr. Greer, Mr. Buckalew and Mr. Kirby. Mr. Kirby recommended that USWC receive a rate reduction of \$15.4 million. In addition, he recommended that USWC's proposed one-time flow-through of tax benefits related to the Tax Reform Act of 1986 be increased by \$829,000 to a total of \$1,289,000.

11. On November 4, 1991, USWC filed rebuttal testimony.

12. On November 4, 1991, the Commission issued Order No. 5535c, which identified new issues. The Commission found that these issues should be addressed by USWC and other parties by filing written testimony.

13. On November 14, 1991, USWC filed a Motion for Reconsideration of the Procedural Order.

14. On November 18, 1991, the Commission suspended the November 22, 1991, deadline for USWC to file testimony on new issues.

15. On November 25, 1991, MCC filed a response to USWC's Motion regarding the hearing date and certain new information in USWC's rebuttal testimony.

16. On December 9, 1991, the Commission issued Order No. 5535d which amended the procedural schedule.

17. On January 15, 1992, USWC filed its testimony on the new issues.

18. On February 5, 1992, the Commission issued a Notice of Telecommunications Modernization Forum scheduled for April 15 and 16, 1992.

19. On February 28, 1992, Pacific Northwest Newspaper Association (PNNA) filed additional issue testimony sponsored by its witness Mr. Thompson. Also on that date additional issue testimony was filed by MCI witness Mr. DiTirro.

20. On March 2, 1992, MCC filed its testimony on the additional issues. The testimony was sponsored by Dr. Greer, Mr. Buckalew and Mr. Kirby.

21. On March 17, 1992, the Commission issued a Notice of Public Hearing scheduled for April 14, 1992. This was the Phase I hearing.

22. On March 17, 1992, the Commission received the Stipulation of USWC and AT&T. On July 16, 1992, the Commission received the Revised Stipulation of USWC and AT&T. The revised stipulation addressed the same issues as the original stipulation, but updated the positions expressed due to numerous procedural changes that occurred since March 17, 1992. The issues addressed by the USWC and AT&T stipulations are summarized as follows:

RATE DESIGN AT&T supported the switched access rate design proposed by USWC with the exception of the transitional, Other Common Carrier (OCC) discount. AT&T advocated the elimination of the transitional rate discounts. USWC did not oppose this modification. USWC stated if the Commission decided to eliminate the transitional rate discounts, the resulting revenues

should be used to further reduce switched access rates.

AFOR PLAN ISSUES Several aspects of USWC's proposed RSP were addressed in the March 17, 1992 stipulation. Regarding the method of capping switched access rates, USWC agreed with AT&T that it would be appropriate to impose a cap at the aggregate level of each of the individual rate elements (local switching, local transport and carrier common line charge) in Montana. The parties agreed that special access should be in the RSP sharing formula. They also agreed an upper limit or "cap" on the earnings that USWC could achieve during the life of the plan was appropriate. However, the parties left open the question of the level of the cap. Regarding the treatment of exogenous variables (separations, tax and accounting changes), USWC recommended netting these variables in an annual review, with concurrence by the Commission, to determine sharing levels. AT&T did not oppose this treatment. Other than MTS and WATS, AT&T is not opposed to USWC's proposed pricing flexibility for non-basic services.

Due to the withdrawal of the RSP on March 26, 1992, the only items remaining in the July 16, 1992 stipulation, regarding AFOR issues, were switched access and special access. Since most pricing aspects of the AFOR were withdrawn, USWC also withdrew the "capped" rate proposal for switched access. In the revised stipulation, USWC did propose to reduce switched access prices in a manner consistent with their policy of reducing access prices toward their Long Run Incremental Cost (LRIC). USWC does not anticipate any circumstances under which it would seek any subsequent increases in the aggregate switched access price level in Montana. USWC continued to support the inclusion of special access in the sharing formula as a service to be benefitted by any sharing credits distributed.

IMPUTATION AND FLEXIBLE PRICING The parties were in agreement that an imputation formula was needed to establish the price floor for MTS, WATS and toll type services for Bell-Originated traffic. The May 28, 1992 stipulation among USWC, AT&T and MCI supplied a basic imputation methodology for Bell-Originated traffic. The parties requested that the PSC determine whether access charges for Independent Local Exchange Companies (ILEC)-originated traffic are appropriate for inclusion in the determination of a price floor for toll. At the conclusion of this Docket USWC will perform an analysis to test rates for each and every toll service. This analysis will be repeated for affected services whenever prices for those toll or related services decrease, or individual contract prices are quoted for any toll or related services, or whenever switched or special access prices increase. USWC and AT&T agreed that in lieu of the proposal for flexible pricing in the RSP, the treatment ordered in the OCC Docket (Docket 88.11.49, Order No. 5548b, effective February 21, 1992) for AT&T would be appropriate for USWC's intraLATA toll and related services. That order provided for maximum rate regulation of providers of interLATA toll and related services and downward rate flexibility upon seven days' notice to the Commission. The relevant rates for designation as maximum rates for this purpose will be the rate schedules in place at the conclusion of this proceeding. The parties further agreed that USWC shall be afforded the benefit of the Commission's "relaxed forbearance."

COSTS USWC and AT&T agree that LRIC, and not fully distributed cost, is the appropriate economic tool for use in pricing decisions. However, the parties disagree to some extent as to the appropriate means of producing LRIC studies. When the "building blocks" workshops that are currently be conducted by the Oregon Public Utilities Commission are complete, USWC and AT&T

will file recommendations as to the appropriate procedure for reviewing the issue. The parties agreed that pending further evaluation of the building blocks concept, USWC's present LRIC studies can be utilized for this Docket, and for a period not to exceed two years from the beginning of the hearing, in pricing decisions by the Commission, so long as prices for services exceed the LRIC, plus appropriate imputation, value.

PIU AUDITS USWC and AT&T agreed that USWC would file tariffs no later than August 1, 1992 that will provide a process for monitoring IXC's reported PIU's. USWC and AT&T agreed that there was no need to further address the PIU issue in this proceeding.

1+ INTRALATA PRESUBSCRIPTION USWC and AT&T agreed that the public policy issues underlying this question have been discussed in the prefiled testimony in this case, and that there is no need to pursue this issue further in this proceeding. Further, USWC and AT&T agreed that the PSC should not take steps toward the implementation of 1+ intraLATA toll presubscription.

EAS USWC and AT&T agreed the PSC should re-examine its rules regarding extended area service through the use of an informal advisory committee. Consideration of this issue in this case should proceed no further.

ONA USWC acknowledged that all ONA services should be made available to all customers, to the extent that the services are technically compatible with the customer's Basic Service Arrangement (BSA). USWC agreed to either list or rate reference in the Montana state access tariff each ONA feature (Basic Service Elements and Complementary Network Services) which is technically compatible with carrier access service at the same price, terms and conditions, as offered to all other



purchasers of the service. The parties agreed that the ONA issues raised by AT&T did not need further discussion in this proceeding.

23. On March 25, 1992, the Commission received the Stipulation of USWC and MCC. The stipulation stated USWC's Net Operating Revenue (NOR) would be reduced by \$12.9 million, plus an additional \$9,000 (\$6,000 for the Center for the New West and \$3,000 for the Western Environmental Trade Association (WETA)) for a total NOR reduction of \$12.909 million. This reduction would be achieved by the booking of \$1.587 million in increased depreciation rates and the booking of \$1.519 million reserve deficiency amortization associated with the retirement of crossbar and step-by-step switches and by a series of rate design changes. The parties were unable to reach agreement on the booking of the \$3.686 million increased expense associated with OPEBs. This issue was reserved for Commission decision. Thus, the net rate effect was a minimum reduction of \$6.117 million and a maximum reduction of \$9.803 million depending upon the Commission's resolution of the OPEB issue.

24. On April 6, 1992, a letter from USWC to MCC revised the adjustment related to the Center for the New West from \$6,000 to \$10,000. The association dues adjustment was revised from \$3,000 to \$20,000. The revised adjustment excluded 40 percent of the Chamber of Commerce dues and all of the Montana Tax Foundation dues. These changes result in a total NOR reduction of \$12.930 million. The maximum and minimum rate reductions are \$9.824 million and \$6.138 million, respectively.

25. USWC submitted proposed rate designs to achieve the minimum and maximum rate reductions. The rate designs included the elimination of two party service, as well as the complete elimination of charges for touchtone service. (The rate designs were revised in a May 4, 1992, letter from USWC to the Commission, and also on May 29, 1992, when the Commission received the Revision to the March 25, 1992, Stipulation of USWC and MCC. The revisions included reductions for Companion Line (hunting) and Custom Calling services, with a small residual amount being spread to switched access and MTS.)

26. USWC agreed to begin accruing the minimum rate reduction as of April 1, 1992. Upon the issuance of the Final Order any monies accrued will be distributed to customers through the use of a one-time credit per the RSP sharing formula. In addition, USWC will provide a one-time credit in the amount of \$761,000, resulting from USWC's failure to properly implement PSC orders regarding excess deferred taxes and uncollectibles.

27. USWC agreed to complete the modernization of its remaining electromechanical switches and to replace analog interoffice facilities by the end of 1995.

28. On March 26, 1992, the Commission received USWC's Motion Concerning Rate Stability Plan. USWC asked the Commission to approve: 1) the withdrawal of the profit sharing provision of USWC's RSP, 2) the withdrawal of all aspects of the pricing flexibility provisions of the RSP except for those concerning Message Toll Service and Wide Area Telecommunications Service (referred to as MTS) and 3) the amendment of the pricing flexibility request for MTS. USWC originally asked that MTS be classified as a non-basic service, with upward price flexibility to a level 25 percent over current rates over the five-year life of the plan, and downward flexibility to a floor of imputed costs plus LRIC, where appropriate. In its amendment USWC requested the MTS rates in place at the conclusion of this case would be treated as maximum allowable rates, and those rates could be reduced (after notice to the Commission) so long as they remained above the imputation plus LRIC floor.

29. USWC stated it had become clear in negotiations with the various parties that large portions of the RSP were likely to be controversial. The Company concluded it was highly likely that the final outcome would be a USWC "veto" of the plan approved by the Commission.

30. On March 31, 1992, the Commission received the Stipulation of USWC and PNNA. USWC and PNNA agreed that the contested case nature of the proceeding would limit their ability to effectively discuss pending ONA issues, and stated a preferable procedural format would be for the Commission to convene an informal ONA conference to contemplate rule-making.

31. On April 3, 1992, USWC filed rebuttal testimony on the

additional issues.

32. On April 10, 1992, USWC filed interlineated testimony for witnesses Mr. Hayhurst and Mr. McClellan. The purpose of filing this testimony was to eliminate portions of the testimony which were agreed to in the stipulations or no longer necessary due to the Company's withdrawal of the AFOR plan.

33. The Phase I hearing began on April 14, 1992, and concluded on April 17, 1992. The issues heard during this Phase were USWC's request to withdraw the AFOR plan, modernization and the reasonableness of the stipulations.

34. On April 15 and April 16, 1992 the Commission held a forum for informal public testimony on the issue of modernization. Those providing testimony included: Mr. Tom Harrison representing the Montana Cable Television Association; Mr. James Cross representing Northern Telecom; Mr. Alan Nicholson; Mr. Tom Cherry and Robert Shepard, M.D., representing Rural Health Telecommunications Task Force; Mr. Jack Ramirez, Chief of Staff to Senator Conrad Burns; Mr. Bob Grummett representing Montana Silversmiths; Ms. Deanna Field representing Big Sky Carvers; Mr. Tony Herbert representing the State of Montana - Information Services Division; Ms. Joan Mandeville representing the Montana Telephone Association; Mr. Richard King; and Mr. David Toppen representing the Board of Regents of the State of Montana.

35. On April 24, 1992, USWC filed the supplemental testimony of Ms. Owen, Ms. Wilcox and Mr. Rees.

36. On May 1, 1992, the Commission issued a Notice of Public Hearing scheduled for June 1, 1992. This was the Phase II hearing.

37. On May 28, 1992, the Commission received the Stipulation of USWC, AT&T and MCI Regarding Imputation. USWC, AT&T and MCI developed a detailed description of an imputation formula to establish a price floor MTS, WATS and toll-type services for Bell-originated traffic. The parties offered the imputation formula for consideration by the Commission. The parties requested that the Commission determine whether access charges for ILEC-originated traffic are appropriate for inclusion in the determination of a price floor for toll.

38. The Phase II hearing began on June 1, 1992 and concluded on June 3, 1992. The issues heard during this Phase were OPEBs, Cost of Service, Imputation and Centron/Centrex Plus.

39. On June 1, 1992, MCI filed the supplemental testimony of Mr. DiTirro.

40. On June 17, 1992, USWC filed the testimony of Ms. Rach-Santos and Mr. Jenson.

41. On June 19, 1992, the Commission issued a Notice of Public Hearing scheduled for July 20, 1992. This was the Phase III hearing.

42. On June 19, 1992, the Commission issued a Notice of Public Meeting regarding the EAS issue. This informal meeting was held July 10, 1992.

On June 25, 1992, USWC filed the revised supplemental testimony of Ms. Owen, Ms. Wilcox and Mr. Rees.

44. On July 13, 1992, USWC filed replacement revised supplemental testimony for Ms. Wilcox.

45. The Phase III hearing was held July 20, 1992. The issues heard during this Phase were proposed rate design, forbearance filings, late payment charge, dual service, Integrated Services Digital Network (ISDN), Digital Switched Service (DSS), and 1+ IntraLATA Equal Access.

#### FINDINGS OF FACT: REVENUE REQUIREMENTS

46. The stipulation between USWC and MCC provided for a net operating revenue reduction of \$12.930 million. The parties agreed to two additional adjustments which result in a rate reduction of \$9.824 million. The first adjustment was the booking of \$1.587 million in increased depreciation rates. (Testimony and exhibits filed on July 15, 1992, for Jerry Harris display the FCC represcription rates. Additional information is located in Tab 3.) The second adjustment was the booking of \$1.519 million in reserve depreciation amortization associated with the retirement of crossbar and step-by-step switches.

47. The proper ratemaking treatment of OPEB expenses remained as the sole revenue requirements issue which was contested between USWC and MCC. The \$3.686 million OPEB expense

increase represented the difference between pay-as-you-go (PAYG) or the cash basis and full accrual which is required for financial reporting purposes by FASB SFAS 106. As a result of this contested issue MCC recommended the maximum rate reduction of \$9.824 million. In contrast, USWC recommended adoption of SFAS 106 for ratemaking which would result in the minimum rate reduction of \$6.138 million.

48. Both parties agreed that USWC would provide a one time credit of \$761,000 to properly reflect the Commission's previous Orders with respect to excess deferred taxes and uncollectibles.

49. USWC agreed to begin accruing a \$6.138 million rate reduction as of April 1, 1992. On June 12, 1992, USWC filed an initial brief regarding OPEBs and an interim rate reduction. At page 15 of the initial brief, USWC agreed to pay interest on the accrued balance under the March 25, 1992, stipulation at the annual rate of 12.1 percent.

50. Prior to the USWC and MCC stipulation, the MCC recommended a \$15.4 million rate reduction. USWC made a financial showing indicating additional revenues in the amount of \$8.1 million would be needed to recover expenses to earn a fair rate of return, but did not request additional revenues in this Docket. The Commission finds the \$12.930 million net operating revenue reduction, as set forth in the USWC and MCC stipulation, represents a reasonable overall revenue decrease and balances the interests of USWC's Montana ratepayers and USWC's stockholders. The Commission wishes to applaud the efforts of USWC and MCC in reaching this revenue reduction. A reasonable result ensued from the stipulation and it is unlikely that a more beneficial public outcome would have resulted from a hearing. In finding this rate reduction to be in the public interest, the Commission is not accepting any particular ratemaking adjustments or methodologies.

#### Depreciation Represcription

51. The Commission finds the \$1.587 million increase in depreciation rates, due to the FCC represcription, to be reasonable.

#### Reserve Deficiency Amortization

52. USWC is removing crossbar and step-by-step switches at an accelerated rate due to technical obsolescence and steadily increasing maintenance expenses. The time frame USWC has proposed for the future life of these switches is 5 years. USWC witness Mr. Lupton commented on the need to replace the switches and the savings that USWC will realize:

... The fact that we're able to remove an entire generation of technology out of our network, and in this case actually two generations with both Step-by-Step and Crossbar being removed, there is substantial savings back below the normal maintenance technician as we normally think about in central office. You no longer have to have any staff support within the corporate headquarters. You have a reduction to zero of spare parts inventory within the business. You have no need to train anyone in the business. You have no need to train anyone in trouble-shooting and analysis and operation of said technology. Those are additional savings that tend to drive the overall corporate expense down on a 14-state basis (Tr. p. 44, lines 10-22).

Mr. Lupton continued:

... In spite of our best efforts, we do have to repair and replace parts as they wear out within the network. As has been reported in earlier testimony, particularly of Jim Hayhurst, no one is producing said hardware today, and they haven't produced it for probably 30 years. We need to maintain a stock either ourselves or purchase it on the reused market around the United States for hardware to be able to either add capacity in terms of lines to a step switch or a Crossbar switch or to replace faulty components.

We need to maintain a certain magnitude of that investment within our territory or in our business so that we can respond as timely as possible to failures. Once we wipe out that technology or those two generations of technology, we no longer need to stock any of that material. That is disposed of immediately. We no longer have to maintain people skilled in the maintenance and operation of said technology. There isn't any in our territory; therefore, we don't maintain the skills. So that reduces the need for ongoing training and administration

of that (Tr. p. 49, line 19 through p. 50, line 14).

MCC witness Mr. Buckalew stated:

... They need to replace these switches.  
It's costing them a lot to maintain. ...  
(Tr. p. 163, lines 23 and 24)

The Commission finds the \$1.519 million in reserve depreciation amortization associated with the retirement of crossbar and step-by-step switches to be reasonable.

53. As a result of accepting the depreciation represcription and the reserve deficiency amortization, the maximum rate reduction is \$9.824 million. The minimum rate reduction of \$6.138 million would result if the Commission accepted USWC's recommendation on the treatment of OPEBs. A discussion of that issue follows.

#### Other Post Employment Benefits (OPEBs)

54. The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 106 (SFAS 106) in December 1990. SFAS 106 is titled Employer's Accounting for Postretirement Benefits Other Than Pensions, and is effective for fiscal years commencing after December 15, 1992. Postretirement benefits are benefits provided by employers to retired employees in the form of payments directly to those retirees or to the third party providers of services to retirees. Examples of OPEBs are medical, dental and life insurance benefits. These benefits do not spontaneously arise when the employee retires, but are instead promised to the employee while they are still employed. SFAS 106 requires that companies recognize the expense of OPEBs during the time employees work in order to match the expense with the time period that the benefits are earned.

55. On December 14, 1990, USWC filed direct testimony in this Docket. USWC witness Mr. Johnson provided testimony supporting the OPEB adjustment at pages 21-22 of his direct testimony. Mr. Johnson's prefiled Exhibit, Schedule 5, related to the OPEB issue. Mr. Johnson proposed the Commission accept the accounting methodologies as outlined in the exposure draft of SFAS 106. Mr. Johnson stated the exposure draft would be implemented in 1993, and indicated the total cost to Montana

ratepayers would be less if the Commission started to fund OPEB expenses now, rather than wait until 1993. The USWC adjustment represented the costs associated with implementing SFAS 106 for active employees. The amount of the revenue requirement relating to the OPEB adjustment was \$3.219 million.

56. On July 15, 1991, USWC filed revised testimony. The OPEB revisions are located in Mr. Johnson's supplemental testimony, pages 11-13 and Schedule 7. USWC revised the OPEB adjustment to include amounts for retirees. Mr. Johnson indicated that since the time of the original filing FASB had finalized the exposure draft and issued SFAS 106. USWC concluded it was now appropriate to fully reflect all costs associated with implementing SFAS 106. This revision represented an increase of \$2.550 million to the revenue requirement. The total revenue requirement for the OPEB adjustment was \$5.769 million.

57. On September 13, 1991, MCC filed response testimony in this Docket. MCC witness Mr. David Kirby addressed the OPEB issue at pages 7-17 of his response testimony. Mr. Kirby recommended the Commission disallow the OPEB adjustment and permit USWC to continue recovering OPEB expenses on a cash or PAYG basis.

58. MCC stated the use of FASB SFAS 71, Accounting for the Effects of Certain Types of Regulation, would allow USWC to recognize the effects of regulatory policy. The use of SFAS 71 would result in the creation of a regulatory asset equalling the difference between the SFAS 106 method and the PAYG method.

59. Mr. Kirby stated "In theory, accrual accounting more accurately measures income because it allocates expenses to the accounting period in which the revenue or other benefit of the expense occurs." However, Mr. Kirby believes, for ratemaking purposes, the transitional distortions created from changing accounting methods offset the theoretical benefits of accrual accounting. The payment of these transition costs would create an intergenerational equity concern. Current ratepayers would be burdened with costs unrelated to the current cost of service.

60. Mr. Kirby agreed the intergenerational equity concern raised by leaving payments to future generations would be a significant argument for departing from the PAYG method, except



he did not believe this argument was persuasive. He contended the argument was based on the assumption that medical cost inflation would be very high indefinitely into the future. Mr. Kirby cited examples of oil price predictions in the 1970's, gas price predictions in the 1980's and the Tax Reform Act of 1986 as reason to not use speculative assumptions to predict future inflation trends.

61. If the Commission allows a ratemaking adjustment, MCC recommended the adjustment be limited to the portion USWC is presently funding. MCC raised concerns that since SFAS 106 does not require funding, the cash received from ratepayers may not be available for future payment of benefits due the possibility of the cash being dissipated by inept management.

62. On November 4, 1991, USWC filed rebuttal testimony in this Docket. Mr. Johnson updated the revenue requirement for the OPEB adjustment. Mr. Johnson's Schedules 1, 2, and page 3 of Schedule 3 pertained to the OPEB adjustment. The USWC filing made on July 15, 1992, incorrectly calculated the deferred taxes associated with the OPEB adjustment of the retired employees. The revenue requirement was reduced by \$.027 million resulting in a revised revenue requirement of \$5.742 million.

63. USWC witness Mr. Gene Wickes responded to the testimony of MCC witness Mr. Kirby. Mr. Wickes explained the benefits to ratepayers of adopting accrual accounting. Specifically, the adoption of the USWC proposal, including the proposal to fund the full accrual cost of OPEBs, would reduce the ultimate costs of OPEBs to ratepayers. Mr. Wickes indicated assets for other USWC retiree benefit programs, pension and life insurance, have grown with investment income to the point that investment income pays a significant portion of the benefits. Using investment income to pay a portion of the benefit cost will reduce the overall cost of OPEBs to Montana ratepayers.

64. Mr. Wickes stated that failure to recognize the current financial commitment of these benefits transfers the commitment to future generations of ratepayers. This is the intergenerational equity issue of PAYG as discussed by Mr. Kirby. Mr. Wickes disagreed with Mr. Kirby that speculative inflation assumptions were used. The USWC calculations include medical

trend assumptions ranging from 9.0 to 6.5 percent. Insurance company medical trend assumptions are currently 22 to 25 percent per year. Mr. Wickes stated it would be very difficult to classify to USWC assumptions as speculative or to compare them to the assumptions used in the 1970's to forecast oil prices.

65. The hearing for the OPEB issue was held on June 1, 1992. USWC once again revised the level of expense and revenue requirement associated with the adjustment for OPEBs. This revision included corrections to the capitalization ratio, the deferred taxes and also subtracted out PAYG expenses that had been erroneously included for the retired employees. The revenue requirement was reduced by \$1.796 million. The final revenue requirement associated with the OPEB adjustment in this Docket was \$3.946 million. The corresponding level of OPEB expenses were \$3.686 million.

66. The Commission's review of the record established in this proceeding does not result in a wholesale acceptance of either MCC's or USWC's proposals. The Commission finds the full accrual method of accounting for OPEBs is a preferable means of matching the employee benefit costs with utility services from which those costs arose.

67. The Commission recognizes the increased level of OPEB expenses that are placed on current ratepayers when SFAS 106 is implemented. However, to ignore the increasing liability and do nothing but leave it for future generations is not the appropriate course of action. USWC demonstrated in PSC Data Request 519 that overall costs to ratepayers are decreased by implementing and funding the SFAS 106 accrual. Mr. Wickes stated "Using investment income to pay a portion of the benefit cost will reduce the overall costs of these plans to Montana ratepayers" (Exh. USWC-14, p. 4).

68. The Commission is not persuaded by MCC's argument that the USWC inflation assumptions are speculative and should not be used. USWC used medical trend assumptions ranging from 9.0 to 6.5 percent, not the current insurance company medical trend assumptions of 22 to 25 percent per year. Mr. Wickes stated, "USWC numbers are not based on current blips. They are based on long-term historical perspective" (Tr. p. 92). Also, a procedure

is in place for correcting assumptions. Mr. Wickes explained the experience (with assumptions) is analyzed on an annual basis, and the actual gains or losses are then flowed back through the methodology.

Much as the transitional liability is amortized, we will amortize variations in assumptions back over, essentially, the same kind of period ... If we are off on the assumption as to what future medical care will be, we will see that coming into account on an annual basis (Tr. p. 83).

The mechanism is self-correcting, and the way it corrects itself is not to take a blip each year, but essentially will smooth the changes out. The methodology is set up to establish where the trend is and then have it follow the trend, as opposed to being wildly erratic from year to year (Tr. p. 93).

69. The Commission finds the assumptions used by USWC to be reasonable. The self correcting nature of the SFAS 106 method will assist in avoiding the situation described by MCC: "Ratepayers and stockholders of some utilities who 'bet the company' on those illusory forecasts are now paying heavily for that mistake." In the ratemaking process, the same assumptions will not have to be used forever. Instead, assumptions will be updated as future information becomes available. This procedure is similar to the mechanism already established for the treatment of pension expense.

70. The Commission compared the PAYG method and the SFAS 106 method in terms of rate stability. USWC demonstrated in PSC Data Request 519 that the SFAS 106 method results in a greater level of rate stability than the PAYG method. A question posed to USWC by MCC attorney Mr. Nelson was "Mr. Wickes, can you envision a situation where the PAYG method of handling these expenses would not cause rate increases in the future." Mr. Wickes' reply was "No" (Tr. p. 64). As discussed above by Mr. Wickes, the SFAS 106 methodology is set up to follow a trend, as opposed to being wildly erratic from year to year. The Commission finds the SFAS 106 methodology will result in improved rate stability over the PAYG method.

71. The Commission recognizes the level of expense

resulting from the SFAS 106 calculation is directly impacted by the assumptions used by USWC. In light of the Commissions' desire to keep rates stable the Commission advises USWC to keep rate stability in mind when proposing future changes to any of the assumptions presented in this Docket. Although medical trend assumptions and plan benefits may vary as future changes are made in the medical industry, the Commission expects to see few changes in the remaining assumptions used by USWC.

72. For OPEBs, the Commission determines that only funding that is tax deductible shall be recovered in rates. The Commission finds that USWC shall be allowed to recover in rates the amount of the SFAS 106 accrual which is tax deductible.

73. In this Docket, the entire SFAS 106 accrual is tax deductible. As explained by Mr. Johnson, during the beginning years, the first states that approve SFAS 106 funding will receive full tax deductibility because tax limitations are placed on USWC, not on a particular state (Tr. p. 34).

74. USWC proposed to fund the SFAS 106 accrual (Tr. p. 31, Exh. USWC-14, p. 4). The Commission finds funding mandatory. To insure the future availability of the funds for the payment of OPEBs, the Commission finds the use of an external trustee and a tax advantaged trust mandatory. All funds recovered in rates, for OPEBs, shall be deposited into an external trust and receive tax advantaged treatment. The trust shall restrict the use of funds exclusively for the payment of OPEB benefits.

75. USWC is currently using a Voluntary Employee Beneficiary Association (VEBA) trust with the Boston Safe Deposit and Trust Company. The Commission accepts USWC's choice of a VEBA trust with Boston Safe Deposit and Trust Company.

76. Upon termination of the trust and/or termination of all benefit plans providing OPEBs, all excess funds shall be refunded to ratepayers.

77. Should USWC terminate a portion of the benefit plans which provide OPEBs, USWC shall present information to the Commission detailing which benefit plans were terminated, and which benefit plans remain. USWC shall provide reason why existing funds should not be refunded to ratepayers.

78. Regarding the funding for the OPEB benefits, Mr. Wickes

stated "Each jurisdiction will receive credit for assets provided through rates and they will be accounted for separately" (Exh. USWC-14, p. 7). During the hearing Mr. Wickes discussed a procedure that is currently in place for tracking both funds and investment returns by jurisdiction (Tr. pp. 74-75). The Commission finds all OPEB funding by the Montana ratepayers shall be tracked in a separate subaccount. The Commission recognizes the Montana subaccount will not be invested separately, but will be pooled. Also, there shall be a reasonable, proportional allocation of the total investment returns to the Montana subaccount.

79. In order to match the expense with the service rendered, the Commission finds that in the event a segment of the USWC business that is currently regulated becomes deregulated, a portion of the funding that has been received shall be transferred to the deregulated entity. The Commission recognizes that funding is not done on an individual employee basis. However, the amount transferred shall represent a reasonable allocation of funding that has been done for the employees in question. Equally important, 100 percent of the total OPEB liability for these employees shall also be transferred to the deregulated entity. The Commission recognizes that the liability for these employees may be greater than the amount of funding being transferred. Any funding shortfalls shall be absorbed by the deregulated entity. All transfers shall be presented in a rate case, and reviewed by the Commission for reasonableness.

80. Recording OPEB costs as they are earned rather than as they are paid in the future brings greater accountability to the USWC management individuals who are presently making health care decisions. Cost containment measures already implemented by USWC were discussed in PSC Data Request 626. The Commission expects USWC to do everything possible to continue to control costs associated with OPEBs. The Commission will monitor cost containment measures through the PSC annual report.

81. As referenced by Mr. Johnson, limits exist on the level of funding that is tax deductible for a VEBA trust. The Commission encourages USWC to continue exploring other tax advantaged alternatives for the funding of OPEB benefits.

82. The OPEB issue as reviewed by the Commission in this Docket was limited to the question of whether to allow a change from the PAYG method to the SFAS 106 method. The Commission has not reviewed the level of benefits or the benefit programs offered by USWC. The Commission retains the right to review the level of programs offered by USWC in future dockets.

83. The Commission emphasizes the conclusions reached in this Docket pertaining to OPEBs apply solely to USWC. The rapidly changing health care environment, the differing nature of OPEB benefits offered and the appropriateness of each Utility's management decisions to control these costs now and in the future, all require a review of each Utility on a case-by-case basis.

84. As a result of the Commission's decision with respect to OPEB expenses, the Commission accepts a \$6.138 million rate reduction in this Docket for USWC.

#### FINDINGS OF FACT: ADDITIONAL ISSUES

##### Percentage Interstate Usage (PIU)

85. On September 12, 1991, AT&T filed testimony in this Docket. AT&T witness Dr. Barrett Zahn provided testimony relating to the PIU issue at pages 49-54 of his direct testimony. Dr. Zahn's prefiled Exhibits 1, 3, and 4 related to the PIU issue. Dr. Zahn identified two problems which can occur when PIU arbitrage takes place: (1) USWC collects less intrastate revenue than it should, and (2) arbitrage can adversely affect the ability of other carriers to compete.

86. Dr. Zahn noted that interexchange carriers (IXCs) self-report the percent of interstate access usage (PIU) to USWC from whom they purchase access. This usage percentage is used to determine which jurisdiction's access rates (interstate or intrastate) will be applied to an IXC's access minutes of use purchased from USWC. At the present time interstate access charges are lower than intrastate access rates; the difference in rates makes it very beneficial financially for some IXCs to overstate the percentage of interstate usage. Currently in Montana there are no audits, controls, or penalties to restrain misreporting of PIUs.

87. South Central Bell conducts audits on IXC's self-reported PIUs. Dr. Zahn's Exhibit No. 4 showed the following results from several Mississippi PIU audits:

	PIU BEFORE AUDIT	PIU AFTER AUDIT
Carrier A	77%	25%
Carrier B	92%	15%
Carrier C	63%	19%
Carrier D	67%	31%

While those results from Mississippi may not be a precise quantification of the misreporting of PIUs in Montana, they are nevertheless cause for concern. The response to PSC Data Request No. 465 showed reported PIU information for 33 IXCs in Montana. Of that number only 15 showed any percentage information and of those companies, only 4 had an intrastate usage amount in excess of a single percentage point. When the self-reported PIU information from IXCs operating in Montana is contrasted to the PIU numbers for Mississippi, the cause for concern is obvious.

88. AT&T recommended that the Commission require USWC to conduct a reasonable number of annual audits of IXCs. AT&T went on to state that the Commission could direct that the requirement for an audit and the terms and conditions of the audit be stated in USWC's intrastate switched access tariffs. A similar requirement could be put into effect for each local exchange company (LEC).

89. Dr. Zahn indicated that a recent stipulation in Colorado dealt with the issue of arbitrage. That stipulation was signed by USWC, AT&T, the staff of the Colorado Commission and the Colorado Office of Consumer Counsel. The Colorado Commission, in its final order stated: "there was convincing evidence that misreporting was occurring in other states and that this is an industry-wide problem."

90. On November 4, 1991, the Commission issued Order No. 5535c which asked the parties to comment on a number of additional issues, including PIU. That Order asked how the issue of PIU should be resolved in terms of the revenue requirement in this and all future cases and requested advice on how to ensure that PIU information was properly reported by each participant in

the intrastate toll market. The Order also asked if USWC should conduct audits on all IXCs prior to the hearing in this Docket (as well as annual audits in future years) and reflect the increased carrier access revenues if any resulted. Finally, the Commission asked if it was determined that insufficient time existed to perform such audits prior to the hearing, should the Commission impute additional carrier access revenues. The Order made it clear that any such imputation would need to be based on supportable evidence.

91. On November 4, 1991, USWC filed rebuttal testimony in this Docket. USWC witness Ms. Wilcox at pages 7-10 of her rebuttal testimony responded to the testimony of AT&T's witness Dr. Zahn. Ms. Wilcox explained why it is necessary for IXCs to self-report PIU data to USWC:

For calls that originate on Feature Groups A or B, the customer doesn't dial the number being called until after USWC has connected the customer to the IXC; therefore, USWC has no information on the destination of that call and whether it is crossing a state boundary or not. Similarly, USWC has no information on the jurisdiction of calls it terminates for a carrier, because the Company does not know where the call originated. The only switched access service for which USWC can determine the jurisdiction of the call is direct-dialed calling originating on Feature Groups C and D. Therefore, USWC's tariff calls for IXC customers to report to the Company their percentage of interstate usage (PIU) for all Feature Group A and B traffic. Up until this point in time, USWC's tariffs have called for the Company to apply the PIU recorded for originating Feature Groups C and D to the traffic terminating on Feature Groups C and D (Rebuttal, p. 8).

Ms. Wilcox recommended that the carriers be required to submit directly to the Commission on an annual basis the same PIU numbers being reported to USWC. The Commission could require an audit by an independent auditor in instances where it felt one was warranted.

92. On January 15, 1992, USWC filed testimony on the PIU additional issue. The two witnesses who filed testimony on this issue were Mr. Johnson and Ms. Wilcox. In her additional issue testimony Ms. Wilcox continued to advocate that a system of



annual reporting to the Commission be adopted. Ms. Wilcox found that the tariff language proposed by AT&T's witness Dr. Zahn was consistent with her recommendation. Ms. Wilcox stated that PIU auditing would be expensive and time consuming and therefore should not be required without good cause. Mr. Johnson's testimony indicated that at the present time there is no record before the Commission that had quantified the level, if any, of misreporting of the intrastate minutes of use by IXCs.

93. On February 28, 1992, MCI filed testimony on the PIU additional issue. The MCI witness Mr. DiTirro at pages 57-61 of MCI's testimony on additional issues noted that MCI employs the accounting firm of Price Waterhouse to conduct an annual compliance audit of its PIU system. MCI stated that since no problems regarding misstated PIUs have been reported, it would be a case of over-regulation to require such reporting. USWC has admitted that the Company has not performed any PIU audits in Montana. Given that reality, the Commission does not expect that any problems with self-reported PIUs would have been identified.

94. On March 17, 1992, USWC filed a stipulation between USWC and AT&T. That stipulation included a section on the PIU issue. At page 9 of the proposed stipulation, there is a section entitled PIU AUDITS. USWC and AT&T agreed that USWC would file tariffs no later than August 1, 1992, that would provide a process for monitoring IXC's reported PIUs. The filing of tariffs was to provide the parties and all affected IXCs the opportunity to review and comment on PIU issues. USWC and AT&T agreed that there was no need to further address the PIU issue in this Docket.

95. The Commission is very concerned about the accuracy of self-reported PIU data filed in this Docket. While there is no direct evidence that IXCs have misreported their PIU data, a comparison of reported PIU data in Montana with that shown by Dr. Zahn from Mississippi, suggests that a problem may well exist in this area. The Commission adopts the portion of the stipulation between USWC and AT&T pertaining to the PIU issue and finds that a tariff filing should be made by USWC. The Commission finds that there is no evidence in this record to support making an adjustment to the revenue requirement to impute

additional carrier access charge revenues in this Docket. However, the Commission wishes to make it clear to all parties that correct reporting of PIU data is mandatory. It is unacceptable for any company to misreport its PIU data.

96. On July 31, 1992, USWC filed Tariff Transmittal 92-25, the PIU Reporting Compliance filing agreed to in the March 17, 1992, stipulation with AT&T.

97. On August 7, 1992, MCI requested a hearing on USWC Tariff Transmittal 92-25.

98. On September 14, 1992, the Commission issued Order No. 5650, in Docket No. 92.7.51. This Docket was established to address the PIU issues identified in Docket No. 90.12.86 and USWC Tariff Transmittal 92-25.

#### 1+ IntraLATA Equal Access Capability

99. On November 4, 1991, the Commission issued Order No. 5535c in Docket No. 90.12.86. This Order identified new issues which the Commission was interested in having parties address. One of those new issues was 1+ intraLATA equal access capability. The Commission asked parties to comment on the desirability of including in USWC's proposed network modernization program the necessary investments to allow 1+ intraLATA equal access capability. The Commission stated that testimony on this issue should focus on the effect 1+ intraLATA equal access would have on universal service and whether this would be a proper avenue to encourage competition. Additionally, USWC was directed to identify the total costs to upgrade the network for 1+ intraLATA equal access capability.

100. Testimony on the 1+ intraLATA equal access issue was filed by USWC, MCI and MCC. Three USWC witnesses filed testimony on this issue: Mr. Purkey, Mr. Wiseman and Mr. Carnes. Mr. DiTirro for MCI filed testimony on this additional issue. MCC witness Mr. Buckalew filed testimony on 1+.

#### USWC Direct Testimony

101. Mr. Purkey stated that, in his opinion, equal access from the consumer's perspective is not the issue. The issue really is whether customers can sign up with USWC and

presubscribe to a carrier of their choice for intraLATA calling. This is a process whereby a customer can access a pre-selected interexchange carrier (IXC) of his/her choice for intraLATA calling by dialing 1 plus the telephone number of the called party.

102. Mr. Purkey provided a background on how intraLATA 1+ came about:

Both the interLATA and intraLATA 1+ processes which are currently in place are the result of the divestiture of the Bell System. Because of the Modified Final Judgement (MFJ), the Bell Operating Companies (BOC) were precluded from the provision of interLATA toll services, but were permitted to continue providing local exchange service and interexchange service within the LATA.

Although the MFJ required the BOCs to provide equal access to IXCs for intraLATA communications, this access was equal to that provided specifically to AT&T, not the BOCs themselves. States were given the option to define it as access equal to that which the BOC gives itself (i.e. intraLATA 1+ presubscription). On an intraLATA basis, the access equal to plus 0, plus a three digit code assigned to the IXC, plus 1 or 0, and then the telephone number of the called party (Direct on PSC Issues pp. 24 & 25).

Mr. Purkey stated that: "For intraLATA, equal access means only that all IXCs are treated equally; it should not be construed to mean that the IXCs are given intraLATA 1+ presubscription capabilities."

103. Mr. Purkey provides a number of reasons why the Commission should not allow 1+intraLATA presubscription. USWC advocates competition where all competitors are playing under comparable conditions. USWC feels that implementation of 1+ would make the competitive environment patently unfair for USWC without other corresponding changes in things like carrier of last resort, designated carrier, ability to compete only in the intraLATA environment, and how subsidies are currently supported.

104. According to Mr. Purkey, proponents of 1+ should have the burden of proof to demonstrate that increased competition from 1+ will provide monetary benefits (or service benefits of comparable value) to ratepayers which will more than offset rate

increases necessary to support 1+ on an on-going basis. He contended that USWC would be at a significant competitive disadvantage in Montana if it is implemented.

105. Mr. Purkey discussed the cost of implementing 1+. He noted that Mr. Wiseman did a detailed study on the implementation costs and Mr. Carnes took those numbers and added other costs which are necessary for conversion to 1+. Mr. Purkey concluded that while the estimated installation amount may be large, the continuing revenue losses and major policy ramifications should be the primary concerns of the Commission.

106. At the conclusion of his testimony Mr. Purkey identified issues which need to be addressed from USWC's perspective before the Commission proceeds with implementation of 1+:

- How to make up for the lost contribution that currently helps support local service;

- How to create a situation that allows USWC to fairly compete in Montana when it is prohibited from carrying interLATA traffic;

- How to fairly alter USWC's carrier of last resort obligation;

- How to fairly alter USWC's designated carrier obligation;

- How to fairly maintain statewide average toll rates if competitors can pick and choose areas to serve;

- Whether enough people will actually benefit from 1+, when there are other comparable alternatives available and a sizeable percentage of people don't make any intraLATA toll calls, anyway.

USWC is adamantly opposed to implementation of 1+ without other corresponding changes in the regulatory structure to provide for equity in competition.

107. Mr. Wiseman, who is a member of the network planning department in USWC, provided testimony on the changes which would be required in the USWC intraLATA toll network in Montana to provide intraLATA equal access services for all carriers using an equal access feature similar to the feature used for interLATA equal access.

108. According to the Company, only 38 USWC end offices provide interLATA equal access. Of those 38, 27 are stored program control and 11 are electromechanical offices which provide equal access for 223,221 network access lines. Thus, 71 percent of the 315,313 USWC network access lines currently provide interLATA equal access. None of the USWC end offices have the capability to provide intraLATA equal access services. It will be necessary according to USWC for the equipment vendors to provide new end office software features for 1+ intraLATA equal access.

109. Mr. Wiseman explained what feature development would be required to provide the intraLATA equal access feature:

The intraLATA feature will provide the end user with the ability to select any IXC or the local exchange carrier as their Primary IntraLATA Carrier (PIC). They can select the same PIC that they have chosen for their interLATA PIC or they can choose a different PIC for their intraLATA service. If they select the LEC as their intraLATA PIC, they will still be required to select an IXC to provide their interLATA service. Thus, the intraLATA equal access feature coupled with the interLATA equal access feature will provide a 2PIC equal access service for the end users (Direct PSC Issues p.6).

110. Mr. Wiseman provided cost estimates for Right To Use license fees for 132 USWC end offices to provide 1+ intraLATA equal access. He also estimated the total generic upgrade costs and network reconfiguration costs. He further estimated that there would be operations support system costs.

111. At the end of his testimony Mr. Wiseman noted that before the cost of state-wide intraLATA equal access in Montana could be determined, each LEC would have to complete a network planning study similar to the one he prepared for USWC.

112. Mr. Carnes filed testimony which described the cost study for intraLATA equal access service in Montana. The economic cost of this service was estimated using LRIC. Inputs into the cost study included: the engineering plan, support systems modifications and balloting/subscription and advertising costs.

MCI Direct Testimony

113. MCI through its witness Mr. DiTirro filed testimony on the issue of 1+. Attached to that testimony were two reports: (1) Report of the Equal Access and Presubscription Implementation Study Committee to the Minnesota Public Utilities Commission and (2) Task Force Report on Issues Related to the Implementation of IntraLATA Equal Access and Presubscription in the state of South Dakota to the South Dakota Public Utilities Commission.

114. Mr. DiTirro noted in his testimony that dialing parity is important in allowing full competition in the intraLATA toll market. Prior to the advent of equal access in the interLATA market in 1985, the only form of access available to the other common carriers (OCCs) required the customer to dial anywhere from eleven to sixteen extra digits. As a result, the FCC set a fifty-five percent discount for this type of access when equal access was not available in an end office. He did not agree that 10XXX (where XXX is a unique three digit code assigned to an IXC) dialing provides equal access. He stated that the Minnesota PUC found that 10XXX dialing is not equal access. As a result of that decision, the Minnesota Commission has required a twenty-five percent discount on access charges in conforming end offices in which intraLATA 1+ dialing parity and presubscription is not available (Direct p. 8, lines 12-14). Mr. DiTirro recommended that the Commission require the implementation of both interLATA and intraLATA equal access as expeditiously as possible. He also recommended that the Commission adopt a fifty-five percent discount for intraLATA access charges in conforming end offices where intraLATA equal access is not available.

115. In responding to Mr. Purkey's testimony, Mr. DiTirro stated: "USWC over inflates estimates of market share loss, purposely excludes the positive effects of market stimulation and incorrectly focuses on the issue of revenue rather than contribution as the measure of competitive losses" (Direct p. 24, lines 1-3). According to MCI, a more rational depiction of a range of competitive losses would be five to twenty-five percent.

116. Mr. DiTirro observed that USWC estimated the increase in local rates that would result from market loss of toll services. However, his view is that the appropriate factor to

consider when measuring competitive toll losses is the difference between the contribution from toll service and the contribution from access service. According to MCI, USWC failed to provide such a calculation.

117. Once the costs for implementing 1+ intraLATA equal access have been identified, MCI recommended that those costs be recovered over a period of eight to ten years.

#### MCC Direct Testimony

118. Mr. Buckalew the MCC witness stated that it would not be right to force USWC to offer 1+ intraLATA equal access at this time. Reasons given by Mr. Buckalew for his recommendation included: no evidence that the market is workably competitive, access costs of independent carriers, designated carrier, carrier of last resort, statewide average toll rates and the MFJ restriction which prevents USWC from competing in the interLATA toll market. He also noted that competitive carriers must be willing to pay for the costs associated with implementing 1+ intraLATA equal access. Until USWC is allowed to compete in the interLATA toll market, implementation of intraLATA 1+ should be deferred.

#### USWC Rebuttal Testimony

119. USWC filed rebuttal testimony on 1+ intraLATA equal access from Mr. Purkey, Mr. Wiseman and Ms. Rach-Santos De La Rosa. The purpose of Mr. Purkey's rebuttal testimony was to respond to the testimony of MCI witness Mr. DiTirro. Mr. Purkey repeats his support for the option of customers using speed dialers to inexpensively implement their own form of 1+ calling in the intraLATA toll market.

120. According to USWC the fifty-five percent discount on intraLATA access charges in conforming end offices is unnecessary for the following reasons: alternatives to 1+ currently exist, no end offices currently have the capability for intraLATA 1+, fifty-five percent is completely arbitrary, even a fifty-five percent discount would not motivate USWC to convert the end offices since the loss of toll revenues would be greater than any revenue loss from discounted access rates and lastly because USWC

has burdens such as: subsidy support, carrier of last resort, designated carrier, and a restriction from competing in the interLATA toll market.

121. Mr. Purkey disputes Mr. DiTirro's claim that Minnesota has ordered the implementation of 1+ intraLATA equal access. According to Mr. Purkey the Minnesota Commission only ordered a study committee to examine how to implement 1+ if it were ordered. As to the South Dakota Task Force, after its report was issued, the South Dakota Commission closed the docket on intraLATA 1+, which left the status quo in place.

122. With respect to market share loss, Mr. Purkey takes issue with Mr. DiTirro, noting that nowhere in his testimony did Mr. Purkey state that USWC would lose a certain percentage of the market. However, Mr. Purkey does state in the rebuttal testimony that his estimate of market share losses would be in the twenty to fifty percent range.

123. Mr. Purkey conceded that it is reasonable to also look at the contribution effects of implementing 1+. His analysis indicated that the contribution loss is of the same magnitude, although slightly smaller, as the net revenue loss previously presented when toll is replaced by access. USWC continues to see the implementation of 1+ as a significant financial risk. Mr. Purkey concluded his rebuttal by stating: "USWC remains ready for full, but fair, competition. MCI's positions on 1+ do not take Montana any closer to that goal and should be rejected" (Rebuttal p. 22, lines 19-21).

124. Mr. Wiseman noted in his rebuttal testimony that the cost to implement 1+ could not be determined by reference to the Minnesota study. He indicated that a specific study for Montana would be required. Limiting deployment of intraLATA equal access to only the 38 switches that currently provide interLATA equal access would not significantly reduce the costs developed by Mr. Carnes. There would be little cost reduction because 93 USWC end offices will be remote digital end offices. Due to the host/remote end office technology used, the remotes do not require any software or hardware additions to provide interLATA or intraLATA equal access. The equal access software is located in the host office. There is no additional cost incurred to



provide intraLATA equal access to these 93 new digital remote end offices and therefore, no significant cost reduction in the study if they were excluded from the study.

125. Ms. Rach-Santos De La Rosa adopted the testimony of Mr. Carnes in its entirety. She testified that USWC attempted to identify as completely and accurately as possible the costs of implementing 1+ intraLATA equal access in Montana.

#### Stipulations

126. On March 17, 1992, USWC filed a stipulation between the Company and AT&T. Included in that stipulation was the following language on 1+: "AT&T agrees with USWC that the PSC should not take steps toward the implementation of 1+ intraLATA toll presubscription in this Docket. The parties agree that the public policy issues underlying this question have been discussed in the prefiled testimony in this case, and that there is no point in pursuing this issue further in this proceeding. If the PSC decides, despite the policy testimony indicating that this change would be undesirable, to pursue this issue, the parties agree that the Commission should open a separate docket for this purpose and ILEC's that are subject to the jurisdiction of the PSC should be made parties to that proceeding."

127. On March 25, 1992, MCC filed a stipulation between MCC and USWC. In that stipulation the following language on 1+ is found: MCC supports the 1+ provision of the AT&T stipulation.

128. On April 6, 1992, MTA filed the following comments on the 1+ stipulation: AT&T and MCC agree with USWC that intraLATA equal access should not be addressed further by the Commission at this time. Generally, the MTA does not believe that intraLATA equal access is currently in the best interests of the general body of telecommunications customers in the state and supports the stipulations filed on this issue. Any intraLATA equal access discussion must be accompanied by discussions of provider of last resort, the effect on uniform toll rates, recovery of total system costs for all companies, and the implementation costs of both USWC and independent telephone companies. In addition, the Commission should assure itself that IXC's have adequate reporting systems to identify intraLATA traffic to avoid any revenue shifts

to the interLATA or interstate jurisdictions without regard to recovery of costs on the intrastate side.

#### Commission Decision

129. The Commission wishes to thank all parties for their thoughtful and well presented arguments on the questions surrounding the issue of 1+ intraLATA equal access. The purpose of including this topic as an additional issue was to gather further information. On that count, this additional issue was a worthy endeavor. The Commission, in accepting the stipulation between USWC and AT&T with respect to this issue, finds that it is not appropriate to order the implementation of 1+ intraLATA equal access for USWC in this Docket. The Commission will consider opening a generic docket on this issue at some future date. It will not be considered in the upcoming USWC general rate case. When this issue becomes the subject of a future generic docket, all LECs and all IXC's will be parties to that docket. The Commission finds that any future implementation of 1+ intraLATA equal access should occur on a generic basis.

#### FINDINGS OF FACT: COST OF SERVICE

##### Cost of Service Background

130. The cost issues contained in the present Docket were preceded by numerous Dockets involving cost-related issues. The cost issues the Commission faced in the 1980s set the stage for the present incremental cost studies and theories. In the early 1980s, Mountain States Telephone and Telegraph Company (MBT), often proposed prices that reflected fully-distributed costs (Order No. 4948, FOF 116). In one docket, the cost issue was whether MBT's embedded direct analysis or MCC's fully distributed cost study should be used to allocate costs (common and access) to services (No. 83.3.18). Also, during much of the early 1980s, basic access service was residually priced (Order No. 4991, FOF 14), after giving consideration to the revenue toll services contributed in excess of embedded accounting costs (Order No. 4991b, FOF 72).

131. The early 1980s also marked a turning point in the

Commission's expressed concern for how costs ought to be computed. For example, in 1983 the Commission expressed a concern for whether costs reflected long-run avoidable costs (Order No. 4991b, FOFs 113-141). The Commission's intrastate access charge (IAC) Docket brought to the forefront proposals of marginal cost-based prices by many different interests (Order No. 5505f, FOFs 17-25). Cost of service was again the major issue in USWC's Docket No. 88.1.2, wherein USWC's cost studies were found unacceptable.

132. Issues of cross subsidization rarely arose in the 1980s (Order No. 5042a, FOF 7). With the advent of intrastate access charges the issue of toll "supporting" local access prices became a common issue (Order No. 5055a, FOF 7, Order No. 5055b, FOF 8). The first apparent occasion of an explicit residential basic exchange access cross subsidy allegation was raised by USWC in Docket No. 88.1.2 (Order No. 5354d, FOF 68).

Cost of Service Docket No. 90.12.86

133. The Commission will now set forth its findings on cost of service issues. The Commission's findings, or decisions, on these issues were affected by the stipulations entered into by the various parties in this Docket. Because the decisions critically involve the proposals contained in the stipulations, the Commission will not repeat the underlying USWC cost of service testimony in the detail originally filed by the parties. The interested reader is advised to review the various witnesses' testimony.

#### Preliminary Imputation Findings

134. As a prefatory remark the Commission will explain why the issue of "imputation" will be addressed in the rate design section of this Order. Much of AT&T's cross examination of USWC's witnesses focused on the issue of whether "imputation" is a costing or pricing issue. AT&T sought to know which of USWC's costing or pricing experts were responsible for excluding certain costs from the Company's cost-based price floors.

135. The Commission finds that whether imputation is a cost or price issue depends. If the price is one of USWC's monopoly

service prices, such as carrier access (CAC), then it is appropriate to call the issue a price issue and, in turn, debate whether such prices should be imputed in competitive service prices. To the Commission, the reverse holds for independent local exchange company (ILEC) prices. ILEC prices are really a cost issue, although not addressed by USWC's cost witnesses. Whether CAC prices should be imputed, or ILEC prices included in cost of service, is a policy issue which the Commission will address in the rate design section of this Order.

#### Cost of Service Witnesses

136. After USWC's initial filing in December 1990, numerous parties intervened and filed cost of service testimony. USWC's witnesses included Drs. Emmerson and Bowman, Ms. Rach and Mr. Lamm. Dr. Emmerson's testimony covered USWC's various economic theories and principles for costing telecommunication services. Dr. Bowman, Ms. Rach and Mr. Lamm's testimonies addressed the methods used in USWC's cost studies. Second, each of AT&T, MCC and MCI sponsored expert witnesses at the Phase II cost of service hearing. AT&T was represented by Ms. Brightwell and Dr. Zahn. MCI was represented by Mr. DiTirro. Finally, Mr. Buckalew appeared on MCC's behalf.

#### USWC's Cost Theory and Practice

137. As for background on USWC's cost theories, Dr. Emmerson made three general points regarding the need for an enlightened regulatory costing philosophy. First, a key regulatory problem involves harmonizing the promotion of competition with public policy objectives. Since USWC needs efficient rate designs to optimally allocate society's scarce resources, regulation should allow flexible pricing above incremental costs for all but basic services. That is, conservative pricing practices would include all of a service's long-run incremental costs in the price floor (Exh. USWC-28, p. 25).

138. Second, USWC believes the structure of its markets is more contestable than widely recognized. Only by allowing market forces to set prices, in combination with flexible pricing and lifting entry and exit restrictions, will the contestability of

the markets be revealed. In his adherence to contestability theory, Dr. Emmerson asserts whether a market is contestable depends on the market structure. Because of the apparent inability to separate the impacts of regulatory policies and market structure, regulation must be relaxed to experiment with whether a market is contestable (Exh. USWC-28, pp. 10-11).

139. Third, of the various costing theories, fully distributed costing (FDC) is no longer appropriate. FDC methods were developed and used when AT&T dominated the telecommunications market. FDCs rely on financial accounting costs and were suited for pricing when competition could be deterred. Because FDCs reflect "unavoidable" historical costs, not "avoidable" economic costs, they inefficiently use scarce resources, violate principles of cost causation and do not serve the public interest.

140. Thus, USWC's cost philosophy is to reflect relevant avoidable, opportunity costs, in its cost studies (see Exh. USWC-15 and 28). In turn, the long-run incremental costs (LRICs) used by USWC measure total service incremental costs (TSICs). Finally, USWC asserts the uncontroversial definition of TSIC is the costs which are avoidable if service was discontinued (Exh. USWC-28, p. 13 and Exh. USWC-29, p. 7). With this background the Commission will now review and decide the COS issues.

#### Commission Decision: USWC's LRIC Studies

141. The Commission is faced with USWC's cost studies and other parties' criticisms of the same cost studies. While the Commission has some concerns with USWC's cost studies, it finds that the avoided cost theory underlying USWC's cost estimates improves on the historical use of FDC studies.

142. Just as the USWC's stipulation with AT&T conditionally accepts the cost studies performed by USWC, the Commission finds merit in conditionally accepting USWC's cost studies, however, not entirely for the same reasons included in this USWC stipulation. The Commission will discuss in detail the conditions necessary in accepting USWC's COS, and those AT&T raised. Before getting into the detailed COS issues, the Commission finds merit in a general discussion on why USWC's

LRICs are conditionally accepted.

143. First, one can enumerate the parties who support USWC's COS studies; these include MCC and AT&T, although AT&T's support was conditional. Aside from the reasons given for conditionally accepting USWC's COS studies, AT&T also agrees with USWC's use of the "avoided cost" principle (see AT&T's August 31, 1992, Brief, p. 16).

144. Second, the Commission finds USWC's cost studies to produce results that are within a zone of reasonableness relative to FDC studies. That is, relative to FDC studies, LRICs are within a zone of reasonableness, assuming the objective is efficiency. However, as will be discussed, USWC's LRIC effort is not the only contender within this zone, which gives rise to the Commission's conditional acceptance of USWC's LRICs.

145. Third, and to illustrate, two types of issues give rise to a conditioned acceptance. One type of issue involves how USWC computes costs in the present Docket. Rather than absolutely reject USWC's entire cost studies because of a disagreement on certain cost assumptions, the Commission chooses to review the reasons why certain assumptions ought to be revised in USWC's next cost docket. The Commission will note the qualitative cost impact of alternative cost assumptions.

146. The other type of issue involves how USWC's cost studies ought to be revised to reflect different cost theories. Two examples would include total service LRIC (TSLRIC) and building block costs (BBC). Just because the state of the art of costing is in its infancy is no reason to simply abandon USWC's effort in this Docket. Alternative cost theories will have an opportunity for review in a future docket. Because those speculative cost theories have yet to reach fruition is no reason to hold hostage the current cost efforts. However, the Commission is not obliged to uncritically accept any USWC cost study.

147. Thus, to summarize this first issue, the Commission conditionally accepts USWC's cost studies, the conditions for which will be thoroughly discussed in the below findings.

Dilemma With Approving Two Stipulations

It would appear that the Commission cannot simultaneously approve the separate USWC stipulations with MCC and AT&T. This appearance results from the fact that, on one hand, the prices in USWC's stipulation with MCC contain certain cross subsidies and, on the other hand, USWC's stipulation with AT&T states in part:

USWC' present LRIC studies can be utilized for this docket, and a period not to exceed two years from April 14, 1992, in pricing decisions by the Montana PSC, so long as prices for services exceed the LRIC, plus appropriate imputation, value (p. 7, emphasis added).

#### Commission Decision: Dilemma With Approving Two Stipulations

149. For the following reasons the Commission finds that, although a dilemma appears to exist, both of USWC's stipulations can be approved. Chief among the Commission's reasons is that cost of service and price stability are but two of Bonbright's relevant attributes of a sound rate design. The Commission finds that, although USWC's stipulation with MCC exacerbates certain cross subsidies, good reason exists to do so: to mitigate the price impacts that would otherwise emerge. Moreover, both USWC and MCC testified that they consider approval of their rate design stipulation to be consistent with the public interest.

150. Thus, and in summary of this issue, the Commission finds that, although AT&T conditioned its acceptance of USWC's LRIC studies on no cross subsidies in the resulting rate designs, any subsidies that flow from the USWC stipulation with MCC are in the public interest.

#### Duration of Acceptance of USWC's LRIC Studies

151. USWC's stipulation with AT&T has a condition that limits the acceptable duration of USWC's LRIC studies. This condition raises two sub-issues. The first involves what will trigger the Commission's opening of a new USWC cost of service docket. The second is the cost basis for prices if the April 14, 1994, sunset date is reached prior to the conclusion of a new cost of service docket. Each will be addressed in turn.

152. First, and as background, AT&T's Opening Brief (August 31, 1992, p. 7) advises holding in abeyance any BBC effort until

the Oregon Commission issues its initial decision. In contrast, USWC would hold in abeyance any BBC effort until completion of the Oregon PUC's workshop process. MCI's Opening Brief (September 1, 1992, p. 31) suggests a Montana workshop process could begin as early as March 1993. Because USWC's LRIC studies are not totally accurate, MCI's Reply Brief (September 11, 1992) disagrees with the 1994 sunset.

#### Commission Decision: Duration of Acceptance of USWC's LRIC Studies

153. As regards the trigger mechanism, the Commission finds merit in AT&T's proposal to hold in abeyance any BBC effort until such time as the Oregon Commission issues its "initial" decision. Since the Commission does not monitor the Oregon Commission's BBC effort, it is incumbent upon AT&T to alert the Commission of the Oregon Commission's issuance of an initial decision. Upon such notice, the Commission will address AT&T's request to embark on a new cost of service docket for USWC. In so doing, the Commission will make no judgement as to the merits of BBC, whether it be of the Oregon variety or that contained in USWC's current LRIC studies.

154. Second, as regards the April 1994 sunset date, the Commission only note that it will address that issue in the future. The Commission will not likely abandon the conditionally-accepted USWC LRIC studies simply because a date has come to pass. That said, the Commission concurs with AT&T's concern that USWC's cost data and methods need updating.

155. In summary of this issue, the Commission commits to open a new docket to explore alternative costing theories for USWC, but makes no commitment to the duration of approval of USWC's conditionally-approved LRIC studies in this Docket.

#### TSLRIC and BBC

156. In this Docket two cost concepts emerged as issues, TSLRIC and building-block costs (BBCs). TSLRIC is an alternative means of computing incremental costs, and thus differs from USWC's LRIC. In contrast, BBC appears to be an implementation issue. Thus, BBCs could be used with either a TSLRIC or LRIC



philosophy. The following reviews the parties' positions on TSLRIC and BBC, followed by the Commission's decisions.

157. In the June 1992, Phase II hearing, AT&T submitted language from a Colorado docket involving TSLRIC (Exh. AT&T-1). AT&T's Opening Brief (August 31, 1992, pp. 6 and 13) states it agrees in principle with USWC's LRIC, but does not believe USWC's current LRIC studies are correct: costing should use TSLRIC and not marginal costs (MCs) as reflected in USWC's LRIC studies.

158. MCI's opinion on the merit of implementing TSLRICs has varied. MCI's Opening Brief (*id.*, p. 30) concurred with the TSLRIC theory. However, due the daunting task of estimating TSLRICs, MCI concluded LRIC is a workable approximation. MCI's Reply Brief (*id.*, p. 3) reverts to the merit of applying TSLRIC. MCI also asserts USWC agrees that TSLRIC is the only appropriate costing standard that can preclude cross subsidies (*id.*, p. 3).

159. As regards BBC, two parties, MCI and AT&T, are concerned that USWC's costs are not properly functionalized. This is a problem that the Oregon BBC theory will apparently rectify.

160. Certain of USWC's comments on TSLRIC and BBC follow. First, USWC concurred that its LRIC's do not equal TSLRIC, as defined in AT&T's Exh No. 1. However, it is not clear that USWC concedes to the merit of applying TSLRIC, as was suggested by MCI's Reply Brief (*id.*, p.3). It only appears that USWC agrees to the TSLRIC definition (2 Vol I, 137). Dr. Emmerson, appeared not to agree with the merit of using TSLRIC (Exh. USWC-29, pp. 6-8). Second, Dr. Bowman mentioned that USWC's cost studies are BBC studies of specific cost functions (Exh. USWC-16, p. 2).

#### Commission Decision: TSLRIC and BBC

161. The Commission finds that the debate over using TSLRIC and the BBC method to functionalize costs is another reminder of the infancy of telecommunications costing. The Commission intends to address both MCI and AT&T's concerns on TSLRIC and BBCs. As USWC's testimony appears at odds with certain intervenor testimony, the Commission embraces MCC's concern that the Commission not commit to another state's policy without a formal review (September 11, 1992, Reply Brief).

162. The Commission plans a BBC roundtable early in 1993, the date for which will be noticed to the telecommunications service list when confirmed. The intended purpose of the roundtable is to allow the Oregon workshop participants to explain to the Commission the fundamentals of BBC. Since the Commission staff did not have the opportunity to participate in the Oregon BBC process a roundtable will serve to raise both the Commission's and its staff's knowledge levels.

#### Acknowledgement of Subsidies

163. USWC's revised stipulation with AT&T states the Commission should acknowledge the level of subsidy received whenever the PSC determines for public policy reasons that a price should not exceed LRIC.

#### Commission Decision: Acknowledgement of Subsidies

164. The Commission's findings on this request are brief. The request to acknowledge cross subsidies is, in general, denied. The practical reasons for this denial involve the problematic nature of defining cross subsidies and the multitude of prices for which calculations would have to be made. Also, cross subsidy analysis is only as good as the underlying cost study; thus, given the conditional acceptance of USWC's LRIC studies it would not be consistent to then embark on a detailed analysis of cross subsidies.

165. This does not mean the Commission is not concerned with prices that are below cost. The Commission has moved aggressively towards cost-based pricing for every regulated industry, including the telephone industry. The Commission's conditional acceptance of USWC's LRIC studies is a further move to efficiently allocate scarce resources.

#### Definition of Cross Subsidies

166. In order to analyze cross subsidies, one must first define the unit of measure and secondly the relevant costs. Disagreement exists on both components in this Docket as the following illustrates.

167. USWC's stipulation with AT&T requests a "rate" level

subsidy analysis. If by "rate" the stipulators mean a "price," then an inconsistency exists with another USWC witness' testimony. Dr. Emmerson clearly favored analyzing cross subsidies at the "service," and not price level (Exh. USWC-28, p. 17). However, Dr. Emmerson also testified that cross subsidies can exist at the rate, and not the service level. Thus, individual prices below cost create economically-inefficient outcomes: cross subsidies (Phase II, Tr. Vol III, p. 78). Drs. Emmerson and Bowman both asserted that individual prices must exceed individual costs (Exh. USWC-28, p. 33 and Exh. No. 15, p. 7). Dr. Emmerson notes that TSIC is the appropriate measure of cross subsidies (id., p. 17).

168. AT&T's Opening Brief asserts subsidies involve a comparison of price to LRIC and imputed values, but also that total service revenues must exceed TSLRIC (August 31, 1992, pp. 5 and 12).

169. MCI actually proposed analyzing cross subsidies at a level more refined than either of USWC or AT&T. As a workable approximation of cross subsidies, MCI proposed a long-run total incremental cost analysis for each building block (BB), with the spreading of that cost across the units supplied of that BB (Exh. MCI-3, p. 50). MCI also asserts USWC agrees that TSLRIC is the only appropriate costing standard that can preclude cross subsidies.

#### Commission Decision: Definition of Cross Subsidies

170. The Commission's decisions on cross subsidies include findings on the definition and then the policy import of such analysis. First, and based on the above testimony, it is clear that in order to analyze the existence of cross subsidies, one must define the appropriate level of detail and second define the relevant cost.

171. Since one reason for separately tariffed prices is presumably because the benefits of refining prices to that level exceed the costs, it follows that cross subsidy analysis ought to be at the price (rate) level. This is not to mean that cross subsidies that result from price averaging are bad, as price averaging is necessary in regulated and unregulated businesses

alike. There always will exist some level of economically unavoidable price averaging which appears to involve cross subsidization, but which actually does not if all costs are taken into account. For the same reasons, unbundled case-by-case pricing can be justified.

172. Another reason for price-level analysis of cross subsidies involves the provision of monopoly and competitive services. For example, one could have total MTS revenues in excess of total LRICs yet one of the prices could be set below cost in a predatory pricing effort. Thus, Dr. Emmerson's live testimony, proposing to focus cross subsidy analysis at the price level, is correct.

173. One possible exception to a strict adherence of focusing cross subsidy analysis on prices and not services involves the merit of TSLRIC. If TSLRIC is found to be superior to LRIC, and avoidable fixed common costs to two or more services can be identified which are not avoidable by a single service, the issue of a higher level cross subsidy definition emerges. However, the merits of TSLRIC and any relation to cross subsidy analyses are reserved for debate in USWC's next cost of service docket.

174. In summary of this issue, the Commission finds that due to the issues involved in analyzing cross subsidy, an effort is not practical except for services that are synonymous with prices such as customer access. Even at that, the use of the conditionally-accepted USWC LRIC studies to perform exact cross subsidy analyses should be accompanied by relevant caveats.

#### Marginal Cost-Based Price Floors

175. Although USWC's general position on cost-based price floors is to use LRICs, there existed enough uncertainty that AT&T expressed serious concern over occasions when USWC might deviate from a LRIC-based price floor. AT&T asserted that price floors should reflect LRIC-based average incremental costs (AIC), and should never be based on just marginal costs due to predatory pricing concerns (Exh. AT&T-3, pp. 28 and 37).

176. USWC's Dr. Emmerson asserted (Exh. USWC-28, p. 33) that each price, whether tariffed, discounted, or competitively

established under flexible pricing, ought be set at or above LRIC. Exceptions arise in the case of explicit public policies to the contrary, or unless specific criteria are met which warrant a shorter-run or marginal cost-based price floor.

#### Commission Decision: Marginal Cost-Based Floor Prices

177. The Commission finds necessary a finding on what shall generally serve as the cost basis for price floors and, when and how exceptions to this policy will be entertained.

178. The Commission finds that until such time as a future docket revises the method used to compute costs, USWC's LRIC studies conditionally approved in this Docket and as adjusted to include or impute relevant monopoly service prices and ILEC costs shall serve as the cost basis. Case-by-case deviations from this policy may be approved, but only after a thorough and supportive cost filing has been submitted and interested parties have had an opportunity for hearing.

179. Thus, there would be no exceptions to LRIC, except via special PSC approval. Two important reasons underlie this decision. First, no generally approved SRMC study exists for USWC. Second, due to price averaging and the modernization of switches, LRICs are probably more accurate in a prospective sense, which does not mean SRMCs are irrelevant, as SRMCs can exceed LRIC. This is more than a theoretical nicety, given the revelation of the cost to operate existing technologically obsolescent switches.

#### Nominal Carrying Charges

180. The issue of whether to use real or nominal carrying charges (RCCs or NCCs) arose in USWC's prefiled direct testimony. USWC's Dr. Emmerson proposed using NCCs, based on opportunity cost concepts. RCCs differ from NCCs in that the rate of inflation, net of technological change, is incorporated into the RCC. Nevertheless, Dr. Emmerson advised the Commission to assume the rate of technological improvements precisely offsets inflation for all capital investments.

#### Commission Decision: Nominal Carrying Charges

181. The Commission is somewhat frustrated by having to reserve this issue, once more, to USWC's next cost of service docket. For purposes of this Docket the Commission conditionally accepts USWC's LRICs in spite of their use of NCCs. Thus, the Commission feels the responsibility to alert the parties to why USWC must develop and include RCCs in its next cost studies.

182. First, incremental costs vary depending on whether a RCC or a NCC is used. That is, it makes a difference whether one uses real or nominal carrying charge to annualize plant costs. The differences have absolute and relative impacts. On relative grounds, the cost calculations of competitive and monopoly services are impacted differently. This may be one reason USWC has avoided using RCCs. On absolute grounds, the cost-based price floor is sensitive to the choice of real or nominal carrying charges.

183. Second, the Commission finds that USWC's use of NCCs is the exception, not the rule, in cost studies, regardless of the industry one selects. PPL, MPC, GFG, MDU and, more recently, PTI all use RCCs. The Commission is also aware that the participants to the Oregon BBC favored the use of economic RCCs over NCCs.

184. In summary of this issue, the Commission accepts the use of NCCs with reservation in the current Docket and directs USWC to compute and use RCCs in the next cost of service docket.

#### Cross Subsidies: Residential Basic Access

185. Ms. Owen explained USWC's policy of pricing services to "support" the residential basic exchange service (III, 1 TR 59). Inherent in Ms. Owen's choice of the word "support" is the presumption that residential basic access is priced below cost; i.e., residential service is cross subsidized. Actually, the allegation of cross subsidies was explicitly raised by two other USWC witnesses, but in data responses. Verification of Ms. Owen's allegation requires a review of the unit of measure and the cost methodology.

186. Also, and in contrast to Ms. Owen's testimony, is an ironic and interesting point by AT&T. Without identifying what local exchange services it referred to, AT&T asserted that USWC may be attempting to conceal an effort at cross subsidizing

competitive toll services with monopoly local exchange services (AT&T's August 31, 1992, Brief, p. 20). The Commission finds AT&T's point ironic because, up until this Docket, it alleged subsidies flowed from toll to local, not from local to toll as AT&T asserts.

Commission Decision: Cross Subsidies: Residential Basic Access

187. The Commission's findings on this issue are twofold. First the Commission is concerned as to why it appears USWC's LRIC's for residential access are erred. Secondly, the Commission assures parties that this concern has no impact on the primary rate design components in the USWC stipulation with MCC.

188. The Commission doubts whether USWC's basic access (loop) costs are properly computed, a concern that applies equally to business and residence basic access lines. The Commission is concerned that an inconsistency exists between USWC's theory and its practice for costing basic access services. Dr. Emmerson has clearly stated that an avoided cost theory is relevant. In turn, the question Dr. Emmerson asserts one must ask, to implement his avoided cost theory, is whether costs are avoided if service is discontinued (Exh. USWC-28, p. 13). If costs are not avoided, presuming service was discontinued, they have no place in USWC's LRIC studies.

189. Dr. Emmerson illustrated his point in referring to the economic concept of fungibility (Exh. USWC-28, p. 29). Fungible plant is interchangeable between existing and new demand. In actually using "drop lines" in his example, Dr. Emmerson stated that there is no fungibility between new and existing plant such as drop lines. In other words, if an existing customer discontinued service there is no avoidable cost associated with the drop line. Dr. Bowman also stated that the fungibility of distribution cable decreases the further it is from the feeder cable, adding that drop lines are not fungible between customers at different locations (Exh. USWC-15, p. 24).

190. The Commission finds Dr. Emmerson's avoided cost theory correct. The actual cost studies, however, do not apply USWC's theory. Although drop line costs are unavoidable, USWC nevertheless includes the same in its cost studies. As a result,

USWC overstates certain costs. Since the drop line is clearly not an avoided cost if a customer discontinues phone service, such costs should not appear in cost studies, given the accepted definition of avoided costs in this Docket.

191. The inconsistency between USWC's cost theory and its actual practice of that theory involves USWC's assertion that basic residential access is cross subsidized. If drop line costs alone are excluded from the cost studies, USWC's assertion is false for the majority of residential customers - those living inside the base rate area. This finding is not intended to cause any adjustment in the residential or business access prices. Nor is this finding meant to change the USWC proposal to increase the cross subsidies flowing to customers through reduced zone increment charges. The Commission simply felt the obligation to correct assertions of cross subsidies for those residential customers living inside the base rate area. This finding will be revisited in USWC's next cost of service docket.

#### Rebates to Recover Deferred Revenue Decreases

192. As noted elsewhere in this Order the Commission has approved the USWC stipulation with MCC that contained a revenue requirement reduction of approximately \$6.14 million. The stipulation's proposed method of crediting keyed off of USWC's revenue sharing plan (RSP) proposal, as amended to include special access. Rebates would be shared on a pro rata revenue basis. USWC proposed to accrue revenues from April 1, 1992, per the stipulation with MCC. USWC's Brief of June 12, 1992, also applied a 12.1 percent rate of interest to accrued revenues. In a later work session the Commission expressed a preference for a one-time credit in the fall of 1992 to flow through the revenues associated with the April 1, 1992, revenue reduction date in the USWC stipulation with the MCC.

#### Retroactive Ratemaking

193. The USWC/MCC Stipulation contains a provision for refunds of certain revenues collected by USWC from April 1, 1992, until the date of this Final Order in Docket No. 90.12.86. See Stipulation, Paragraphs 1 and 4. This proposal by USWC and MCC



presents an issue with respect to retroactive ratemaking. The legal prohibition against retroactive ratemaking was recently affirmed by the Montana Supreme Court in *Mountain Water v. PSC*, 49 St.Rptr. 632 (1992). The Commission finds that it is not legally empowered to order the proposed refunds due to the retroactive ratemaking prohibition. USWC is legally entitled to retain all revenues collected under existing tariffs up until the date of this Order. See Section 69-3-301, 69-3-302, 69-3-303 and 69-3-305, MCA. The parties have not offered any explanation or exception which would permit the Commission to order the proposed refunds.

194. Notwithstanding the above, the refund provision in the Stipulation is a voluntary agreement reached in this Docket between two formal parties, USWC and MCC. The Stipulation was signed on March 25, 1992, prior to the April 1st date of initial refund accrual. There is evidence in the record that USWC and MCC consider their Stipulation to be an integrated package which is in the public interest. The Commission has in this Order approved the other components of the USWC/MCC Stipulation. Although the Commission lacks the authority to order the refunds provided in the Stipulation, it finds that USWC may voluntarily refund the funds in the amount and manner provided therein, and hereby encourages USWC to do so in order to complete compliance and performance of its agreement with MCC.

#### FINDINGS OF FACT: RATE DESIGN

195. This part of the Order summarizes the parties' positions on the ten rate design issues in the Docket followed by the Commission's findings on the same issues.

196. The ten contested issues include: 1) imputation including independent local exchange company (ILEC) originating charges to USWC; 2) billing information used to achieve a \$6,185,948 revenue reduction in USWC's proposed primary rate design; 3) rate disparity between Local Switching 1 (LS1) and Local Switching 2 (LS2); 4) rate discount for Feature Group A (FGA) and Feature Group B (FGB) access services for other common carriers; 5) pricing flexibility for USWC's toll services; 6) a relaxed forbearance filing process for USWC; 7) general rate

design issues associated with USWC's stipulation with MCC;  
8) USWC's late payment charge threshold; 9) pricing policy for Integrated Service Digital Network (ISDN); and 10) pricing policy for Digital Switch Service (DSS).

#### Imputation

197. A description of the imputation issue and the contested issues in Docket No. 90.12.86 follows. USWC's imputation philosophy and method are first reviewed, followed by a review of AT&T's and MCI's testimony. This is followed by a review of USWC's rebuttal testimony.

198. Mr. Purkey (hereafter USWC) testified on behalf of USWC regarding imputation issues. According to USWC, to impute means to assign. Imputation assigns certain costs of toll services to USWC retail intraLATA toll services. Imputation, in part, establishes a price floor for USWC's intraLATA retail services. Assuming USWC was required to pay the same rates that Interexchange Carriers (IXCs) must pay USWC (Exh. USWC-23, pp. 2-3), imputation estimates what it costs USWC to provide toll services to its retail customers.

199. From a pricing perspective, imputation regards how USWC prices identical services, or service elements, provided to different customers. Services provided by USWC fall into three categories, local switched services (hereafter local), intraLATA toll services and switched access services. USWC sells local and intraLATA services to its retail customers, and switched access services to its wholesale customers.

200. USWC asserts it sells its switched access service to two kinds of customers, its wholesale (carriers) and its retail customers (local). An IXC receives the access services as a list of service elements, while a local customer receives the access services as service elements embodied in a long distance call. No matter who receives the access services, the key point is that the access services are identical to different customers, and thus should be priced at the same level.

201. USWC claims that an IXC, for example AT&T, is entitled to compete in the intraLATA market. However, IXCs are unable to compete without first purchasing switched access services from

USWC. In other words, the IXC has to rely on USWC to access the local network in order to compete with USWC in the intraLATA market. Because the local network is a bottleneck facility provided and controlled by USWC, for economic reasons USWC should charge its retail customers the same rates for the identical service elements charged IXCs (Exh. USWC-23, pp. 2-10).

202. Thus, the overall goal of imputation is to prevent USWC from imposing costs (via switched access services) on IXCs such that the IXCs must price their toll services at a level above USWC's prices. If USWC's toll prices reflect the costs USWC imposes on IXCs, via imputation, then IXCs can compete with USWC on a level playing field. Thus, imputation becomes a matter of how well the switched access costs are managed in order to determine the price floors for USWC's retail services.

203. The method of imputation is also of interest. According to USWC, imputation includes essential service cost elements in price floors for a given service. Essential service elements are the switched access services that IXCs must purchase from USWC in order to provide their competing toll services. In contrast, non-essential service elements are also included in order to generate a price floor for a USWC toll service. Since USWC is prohibited from pricing below the price floor, the Company is treated as if it were a separate IXC who must purchase these essential elements from itself at tariffed rates to provide the service (Exh. USWC-23, p. 3).

204. For a given imputed service, USWC includes the following five switched service elements: Local switching 2, Intercept, Line termination, Local Transport and Carrier Common Line. The non-essential elements are billing and collection, toll assistance, and certain marketing administration.

205. USWC's imputation process starts by calculating the LRICs for service elements. Next, the price for tariffed switched services IXCs purchase from USWC are compared to the LRICs for the corresponding tariffed rates for those service elements (Exh. USWC-23, p. 5). A replacement occurs if the tariffed switched service price exceeds the LRIC, for a given service element.

206. USWC also distinguished between imputation and

imputation tests. Imputation is the process used to determine a price floor for a given service. An imputation test is used to see if the price for a service is below its imputed price floor (Exh. USWC-23, pp. 4-6). As a matter of policy, USWC concludes that if its current price for a service exceeds its imputed price floor, there is no price squeeze or anticompetitive pricing behavior in that service market.

207. USWC also testified as to what criteria should be used to determine if a service needs to go through an imputation test. USWC proposes using two criteria to determine if an imputation test is necessary for a service. The first criterion is whether a USWC provided service competes with an IXC's service. The second criterion is whether IXCs must purchase essential service elements in order to provide that service to compete with USWC.

208. Based on the two criteria, USWC believes its toll services should be subject to imputation and imputation tests. These services include MTS, WATS, 800 Service, customer specific contracts and other toll-type services. Pay telephone service also falls into the imputation category.

209. USWC further states that the above services need to go through imputation tests on a service-specific basis. There is no single, common imputation analysis for all imputation services. The appropriate service elements to impute a given service depend on the characteristics of that service. An element that is essential for one service may not be essential for another service.

210. Based on the above criteria, USWC states that the three most important imputation services are MTS, WATS and 800 Service. MTS is a basic switched long distance service designed for voice communication. It can also accommodate data transmission at speeds of up to 4.8 thousand bits per second (Kbps). WATS is a bulk rate long-distance telephone service that permits calls from one originating location to anywhere in a wide service area. USWC's 800 Service, or Inward WATS, permits calls from a wide service area to a number at no charge to the calling party.

211. USWC specified the essential elements for MTS, WATS and 800 services. For MTS these elements are LS2, Local Transport, Line Termination, Intercept and Carrier Common Line. All

elements apply to both the originating and terminating ends. The essential elements for WATS imputation are LS2, Local Transport, Line Termination, and Intercept for both the originating and terminating ends. Carrier Common Line is for the terminating end only. Finally, the essential elements for 800 Service imputation are LS2, Local Transport, Line Termination, and Intercept for both the originating and terminating ends. Carrier Common Line is for the originating end only.

212. USWC believes it is in the worst of both worlds in terms of the balance it must strike between regulation and competition. The Commission requires USWC to ubiquitously provide toll services at statewide average rates. On the other hand, USWC asserts it competes for intraLATA calls with IXCs who are not required to provide these services based on statewide average rates. USWC further points out as a second disadvantage its being the designated carrier in the Montana intraLATA market. Because of this status, USWC has to provide intraLATA toll services to all independent local exchange companies (ILECs) regardless of whether the service is profitable. Compared to USWC, IXCs have no such responsibilities (Exh. USWC-23, p. 9).

213. Based on the above regulatory constraints, USWC believes the most important imputation issue is fairness. In terms of fairness, USWC believes that there are three conditions which imputation should meet. First, IXCs should not be allowed to price below USWC's imputed price floor for an imputed service, unless their LRICs are below USWC's. Second, imputation should be service-specific. Third, imputation should not include ILEC originating charges to USWC. If these conditions are met, USWC does not oppose imputation.

214. AT&T (Dr. Zahn) believes USWC should perform imputations to set prices for its competitive services, because USWC enjoys the unique position of being both a monopoly and a competitive service provider. AT&T points out that any USWC service that incorporates monopoly local switched service will require an imputation test (Exh. AT&T-3, p. 43).

215. AT&T disagrees with USWC's exclusion of ILEC originating costs in imputation. AT&T argues that ILEC originating access costs are important costs to USWC. An IXC,

such as AT&T, must pay access charges to an ILEC when it carries toll service originating in that ILEC territory. Likewise, USWC must pay the same access charges when it carries the same service. If these ILEC originating costs are not imputed into USWC's toll services, then the imputed price floor is too low, with the impact that USWC must overcharge for other services to cover this underpriced (compared to their costs) imputed service. Thus, AT&T concludes that ILEC originating charges to USWC are incremental costs that must be imputed into USWC toll services. Otherwise, the resultant price floor can be too low, and thus, anticompetitive.

216. MCI (Mr. Ditirro) supports AT&T's testimony, holding that two kinds of access costs should be in USWC's imputation. The first is the access costs for all calls originating and terminating between USWC exchanges. The second is the access costs for those calls that are carried by USWC but originated or terminated in an ILEC exchange (Exh. MCI-4, p. 50). MCI believes that to exclude ILEC originating or terminating costs, as USWC proposed, would result in price floors set below USWC's actual cost (Exh. MCI-4, p. 51).

217. MCI further testified that no separate imputation study would be needed for ILEC originating or terminating services. MCI points out that there is no need to perform a separate imputation study for ILEC originating services even if certain ILEC access charges are higher than USWC's.

218. MCI states that averaged rate policies have served the public interest for decades, allow rural areas to benefit from technological improvements, and have been used historically to avoid higher rates for higher cost areas. Thus, MCI believes the Commission should maintain averaged rates to allow "more people to have better service" at a reasonable price. From this point of view, a separate imputation study would be inappropriate.

219. In conclusion, MCI believes that USWC rates must be sufficient to cover the cost of providing the service in the aggregate. For this purpose, USWC's imputation must include ILEC originating access charges USWC incurs. In handling the ILEC originating charges, separate imputation for the ILEC originating toll services would result in deaveraged rates which are not in

the public interest (Exh. MCI-4, p. 52).

220. In addition to the above issue (ILEC originating services and the associated pricing policy), MCI claims that USWC should be required to conduct imputation studies during each of its rate cases. Any time USWC proposes to increase its rate for any access element or requests pricing flexibility for an imputed service, a recalculation of the imputation should be required by the Commission.

221. USWC submitted rebuttal testimony (Mr. Purkey's) on three occasions: November 1991 (Exh. USWC-24), January 1992 (USWC Exh. No. 25), and April 1992 (Exh. USWC-26), respectively.

222. First, USWC (Exh. USWC-24) rebutted AT&T's proposal to include ILEC originating charges in USWC's imputation. USWC believes that the issue of whether to include originating ILEC access charges in imputation is at the crossroads of regulation and competition (Exh. USWC-23, pp. 3-4). USWC claims that this issue really focuses on the relevant market for imputation, which is its own territory: ILEC territory is not relevant to USWC's imputation. (Exh. USWC-23, p. 4).

223. USWC further asserts two reasons why ILEC originating access charges are not essential elements to IXC's and thus should not be considered in imputation. First, IXC's do not need to originate calls in ILEC territories in order to compete in USWC's territory. Second, since IXC's are free to pick which ILEC they want to carry toll services, IXC's have no obligation as a designated carrier (as USWC has) to service all ILEC's. USWC believes that if IXC's are free to choose the profitable markets, while USWC is not, then fair competition is impaired (Exh. USWC-23, p. 5).

224. Ultimately, USWC believes that imputation is a fairness issue. Principles of fairness and relevancy must guide imputation. In order to be fair, USWC states that there are three conditions under which it would be appropriate to include ILEC originating charges in imputation. First, USWC should be allowed to make a fully independent, competitive business decision to service some or all ILEC's. In other words, USWC would have no obligation to be the designated carrier of ILEC services. Second, IXC's should not be allowed to price their toll

services below USWC's imputed price floor, unless they can demonstrate to the Commission that their LRICs are below USWC's. Third, USWC should be allowed to deaverage its toll rates in Montana. USWC believes this third condition would allow USWC to meet the competition in its territory, while at the same time cover the costs of serving ILEC territory (Exh. USWC-23, pp. 6-8).

225. USWC further clarifies that ILECs' access charges in Montana are significantly higher than USWC's. If the Commission rules that imputation should include these higher charges, then the imputed rates would be higher than would otherwise be the case (Exh. USWC-24, p. 2). That is, if the ILECs' access charges, which are not under USWC's control, are included in imputation, USWC will be forced to price its toll services higher, creating a high price umbrella under which IXCs could easily price their toll services. Thus, USWC's market share would be unfairly eroded.

226. USWC provided an additional reason to exclude ILEC originating charges (Exh. USWC-24). USWC claims that ILEC originating toll services are offered below USWC's LRIC, and thus are subsidized by other services. Historically, there has never been a specific product to support this subsidy; it is subsidized by a contribution from all services. Imputing ILEC originating charges forces the subsidy to be supported by toll services only.

227. USWC rebutted MCI's claim that MCI and other IXCs must also pay the originating and terminating access charges to ILECs. The Company points out that, of the 16 IXCs providing carrier services in Montana, only five serve USWC's 42 Feature Group D exchanges. These IXCs are AT&T, MCI, US Sprint, American Sharecom and TouchAmerica. None of these five IXCs is required to carry intraLATA services. USWC believes its obligation to serve all ILEC territories is the fundamental reason why it is inappropriate to include ILEC originating charges in imputation (Exh. USWC-26, p. 21).

228. In conclusion, USWC believes that the Commission should follow a simple and competitively fair principle for imputation. USWC believes that it should be treated the same as its IXC competitors. That means if USWC has a required social burden,



such as being the designated carrier for all ILEC territory, then that burden should not be considered in imputation.

Commission Decision: Imputation

229. The Commission's decision will first discuss the reasons for finding that imputation is approved. Secondly, the Commission will state its reasons for finding that LRIC-based price floors must include ILEC charges. In this case filing, the Commission finds economic merit to impute Carrier Access Charges (CACs) into USWC's toll service prices. The Commission believes that imputation will provide a fair and competitive environment for intraLATA toll services, which is essential in maintaining just and reasonable toll prices in Montana. Thus, the Commission approves the stipulation offered by USWC, AT&T and MCI on May 28, 1992. The Commission finds reasonable the stipulation's method to establish price floors for MTS, WATS, 800 and toll-type services for Bell-originated traffic.

230. In approving this stipulation on this issue, the Commission reminds the parties that all stipulated issues will be fully examined in USWC's next general rate filing. These stipulated issues include the following.

231. First, USWC should establish price floors for its products and services that use monopoly services (monopoly input) as a component. Price floors must reflect relevant Long Run Incremental Costs (LRICs) and the imputed price of monopoly components.

232. Second, LRIC-based imputation amounts should be determined on a service-by-service basis. Thus, imputation amounts should not be identified for time-of-day, day-of-the-week, individual mileage bands, or individual usage blocks.

233. Third, imputation services include, but are not limited to MTS, WATS, 800, and other equivalent toll-type competitive services. Toll-type services also include individual bulk toll offerings within toll services, such as volume discounts.

234. Fourth, the rates USWC charges each of its toll services shall be sufficient to recover the intrastate premium access tariff rates for access services that USWC provides to IXC's. These toll service rates shall also recover all other

relevant LRIC costs, for example, billing and collection, toll assistance, marketing and administration, advertising, product management, access, and billing & collection expenses paid to ILECs for calls originating in USWC territory.

235. Fifth, the access services used to compute imputation price floors include the Montana premium rate for the Carrier Common Line (CCL) charge, the Local Switching 2 (LS2) rate, the Line Termination rate, the Intercept rate, and the Local Transport (LT) premium rate per minute for the mileage band that is the mean band of all IXC usage in Montana. In addition, 800 service shall include the 800 service Identification Charge.

236. Sixth, if USWC finds that the actual cost of providing a service exceeds the current price floor for that service, then it must revise the price floor to reflect the actual cost to provide that service. The method of computing the new price floor must be in accordance with incremental cost techniques as outlined above.

237. Seventh, USWC may offer individually negotiated contracts for toll service customers who are considering special access connections with other IXCs. USWC should establish a price floor for individually negotiated contracts based upon the tariffed price for Special Access and all LRIC costs if USWC intends to and actually does provide the service using Special Access. USWC may not establish the price floor of an individually negotiated contract based upon the price of Special Access if USWC intends to or actually uses Switched Access. Authorization to negotiate such individual customer contracts must be requested pursuant to the relaxed forbearance process approved in Findings of Fact Nos. 270-272 of this Order.

238. Eighth, contracts for services offered by USWC that have a monopoly service input shall recover the price of the monopoly input, in addition to all other relevant LRIC costs.

239. The remaining contested imputation issue involves whether USWC should include the access and billing costs it pays to originate calls in ILEC territory in its imputation formula to determine price floors for the competitive intraLATA toll services. The Commission finds that USWC must include ILEC originating charges and billing costs in computing price floors

for all of its intraLATA competitive services, including MTS, WATS, 800 Service and other toll-type services. The Commission's reasons follow.

240. First, the Commission finds that excluding ILEC originating charges to USWC will be inconsistent with the imputation principle. In theory, USWC agrees that all relevant costs in providing intraLATA toll services should be included in an imputation formula. Thus, the Commission finds that the access and billing charges USWC pays to ILECs are indeed relevant costs USWC incurs to carry ILEC originating toll services. In other words, these ILEC originating charges are relevant costs for USWC's toll service prices originating from an ILEC territory and terminating in USWC territory (I-B type traffic). If USWC determines to carry I-B type intraLATA toll services, USWC will incur these charges.

241. Second, the Commission finds if USWC did not carry such traffic, these costs (ILEC charges to USWC) would be avoided. Thus, the Commission finds that excluding ILEC originating charges would be inconsistent with the avoided cost pricing principle -- USWC's LRIC pricing principle in this Docket.

242. Third, the Commission finds that excluding ILEC originating charges will create an unequal and thus unfair competitive environment among competitors in the intraLATA toll market. USWC's competitors must pay the ILEC access and billing charges for their intraLATA toll traffic on equal footing. No competitor (except USWC) can exclude these charges in their cost-of-service calculation to determine their competitive prices in this market to compete with others. If ILEC originating access and billing charges were excluded, USWC and its competitors would compete on unequal ground. USWC would have an unfair competitive advantage over its competitors in the competitive intraLATA toll market.

243. USWC contends that it is "required" to be the designated carrier/carrier of last resort for toll services in Independent Local Exchange Company (ILEC) exchanges (USWC Reply Brief, p. 3). USWC is not required to be the ILEC toll carrier by any Montana statute, administrative rule or Commission Order. The Commission agrees with the position of AT&T on this issue

(AT&T Reply Brief, pp. 3-5).

#### Billing Information in Rate Design

244. The following summarizes the billing information issue. The issue involves the billing information used in USWC's rate design to achieve the revenue reduction of \$6,185,948 in this Docket. A review of the parties' testimony follows.

245. First, MCI recommends the Commission order USWC to use current billing information in its rate design. MCI opposed the stipulated rate design regarding access service charges, arguing that the test year (July 1, 1989, to June 30, 1990) data are stale. Due to reconfiguration and efficiencies that have been achieved in its network, MCI claims that the proposed rate reductions will not result in cost savings to MCI as USWC forecast. MCI believes that the rate design based on these stale test year data will create a windfall for USWC instead of reducing USWC's revenues as claimed by USWC in its rate design proposal.

246. USWC believes that MCI's proposal will destroy the concept of an historical test period, and thus should be denied. In its reply brief, USWC states that selective updating is not valid. By its very definition, USWC believes that historical test period data will always be dated and differ from current financial and billing determinants. Thus, the Commission should adhere to its traditional approach of using an historical test year in this Docket.

247. AT&T also disagrees with MCI's proposal to update billing information in USWC's rate design. AT&T argues that if more recent data are used for new access rates in USWC's rate design, then similar data should also be used to determine new rates for all other services. If updated volumes and quantities are used for new rates for all services, then updated expenses, revenues, and rate base should be used to update the revenue requirements. Thus, AT&T concludes that another hearing would be needed to examine all of the new material.

248. MCC also opposed MCI's proposal to update billing data. MCC reminds the Commission that data must be known to be analyzed in advance of each rate case. If MCI's argument is valid, then

rate design in every docket is stale. MCC believes that the Commission cannot deal with a moving target in this rate case. In addition, MCC states that if the Commission wants to update switched access data it has to update all service's billing data in this Docket.

#### Commission Decision: Billing Information in Rate Design

249. The Commission denies MCI's proposal to update billing data in USWC's primary rate design to achieve a \$6,185,948 revenue reduction. The Commission accepts the test year billing data used by USWC in its rate design. Although somewhat dated, the use of an historical test year necessarily involves using stale data. Although the Commission agrees with MCI that USWC's load pattern may have been significantly changed since the end of the test year (June 30, 1990), if more current data were used for new access rates, then updated information is needed to determine new rates for all services. Moreover, if more recent data were used in rate design to reflect changes since the end of test year, then all other data, including expenses, taxes, rate base, revenue requirement and revenue, would have to be renewed in this filing.

#### LS1/LS2 Rate Disparity

250. The following summarizes the parties' positions on the issue of rate disparity between Local Switching 1 (LS1) and Local Switching 2 (LS2). First, AT&T proposed eliminating the rate disparity between LS1 and LS2 in this Docket. LS1 and LS2 are two different access switching services defined by the Federal Communication Commission (FCC) prior to the 1984 divestiture. LS1 is a switching service for local exchange minutes of use. LS2 is a switching service for toll minutes of use. Prior to divestiture, the FCC established different LS1 and LS2 rates, with the result that AT&T's competitors have had lower rates. After divestiture, the FCC found (Docket No. 80-286) that there is no difference in the toll call and local call switching costs when analog and digital electronic switches become available. Thus, AT&T believes that the cost basis for the rate disparity of LS1/LS2 no longer exists. In addition, AT&T asserts that the FCC

has established a timetable to merge the LS1 and LS2 rate elements. According to the FCC's table, 99.5 percent of the LS1 and LS2 rate disparity will be eliminated by the end of June 1993. For these reasons, AT&T recommends eliminating LS1 and LS2 rate disparities in this Order.

251. In its reply brief, MCI opposed AT&T's request to eliminate the LS1/LS2 rate disparity. MCI states that the proposed elimination of the LS1/LS2 discount is a blatant attempt to ensure AT&T has an unfair competitive advantage. MCI believes AT&T misstated the status of equal access conversion in the state of Montana. MCI states that AT&T has not established that equal access conversion is sufficiently complete in Montana to warrant the elimination of the disparity. Thus, MCI recommends maintaining the LS1/LS2 rate disparity until the conversion to interLATA equal access is complete.

252. USWC asserted that MCI confused the elimination of the LS1/LS2 rate disparity with the elimination of the Other Common Carrier (OCC) discount. According to USWC, the rate differential between LS1 and LS2 should be removed, making the rates for all feature group services the same (Exh. USWC-32, p. 8). As regards the second issue, elimination of the OCC discount of 27.5 percent for Feature Group A and B access non-equal access offices as proposed by AT&T (Exh. AT&T-3, pp. 21-25), USWC recommends eliminating the rate disparity between LS1 and LS2 because there are no cost differences, and the FCC has mandated elimination of the disparity by the end of June 1993. USWC presented testimony regarding the additional revenues that should be collected if AT&T's proposal to eliminate the OCC discount was approved (Exh. USWC-34, p. 4).

253. The Montana Consumer Counsel did not object to the elimination of LS1/LS2 rate disparity which was included in its stipulation with USWC as one item of rate design proposal.

Commission Decision: Rate Disparity between LS1 and LS2

254. The Commission approves AT&T's proposal to eliminate the LS1/LS2 rate disparity. The Commission finds that with today's switching technology (analog and/or digital electronic switches being used by all local telephone companies), there no

longer exists any LS1/LS2 cost difference. Thus, there is no cost basis for the rate disparity between these two different switching services. In addition to the above economic reasoning, the FCC in Docket No. 87-113 ordered a five-year transitional period from 1988 to June 30, 1993, to merge LS1 and LS2 rates. In this Order, the FCC set up a timetable to merge the interstate LS1 and LS2 access rate elements. According to this timetable, between July 1992 and June 30, 1993, 99.5 percent of the LS1/LS2 rate disparity will be eliminated in USWC's interstate access tariffs. On the intrastate side, the Commission feels that it should keep the same pace in merging the rate disparity between LS1 and LS2 in the State of Montana.

#### OCC Rate Discount

255. The following section provides the parties' positions on the issue of eliminating the Other Common Carrier (OCC) rate discount. AT&T recommends eliminating the OCC discount. According to AT&T, the OCC discount was originally developed to encourage competition in the interexchange telecommunications market. In its brief, AT&T further states that the purpose and need for the discount has expired, adding that there is no cost difference to provide AT&T and the OCCs access service.

256. MCI's position on this issue was unclear. As pointed out by USWC and AT&T, it seems that MCI confused this OCC discount issue with the LS1/LS2 rate disparity issue. MCI's briefs, however, suggest that MCI opposes AT&T's proposal to eliminate the OCC discount. In its brief, MCI states:

Even if the dollar amount at issue, \$140,000, is not considered by AT&T to be a "big money item," it is an important issue to MCI. AT&T has certainly not established that equal access conversion is sufficiently complete in Montana to warrant the limitation of the discount. Accordingly, it should be maintained. Until the conversion to interLATA equal access is completed under the schedule set forth in U S West's Network Improvement Plan, this Commission should

maintain the discount, rather than eliminate it, as the latter course would provide AT&T with an unwarranted and unfair competitive advantage in the interLATA market (MCI Reply Brief, p. 19).

#### Commission Decision: Access Rate Discounts for OCCs

257. The Commission approves AT&T's proposal to eliminate the 27.5 percent discount for intrastate originating and terminating FGA and FGB access services offered by USWC to OCCs. Since AT&T is prohibited from using FGA and FGB access services, the discount currently does not apply to AT&T. The Commission finds no cost difference to justify providing the discounted access service to OCCs. The current rate discount for FGA and FGB is not cost-justified. The Commission also believes that the remaining 27.5 percent rate discount for FGA and FGB originating and terminating access services may induce OCCs to arbitrage tariffs among local exchange companies, as evidenced from the recent Docket No. 91.4.14 (Econo-call vs. PTI).

#### Pricing Flexibility of Toll Services

258. The following section summarizes the parties' positions on the issue of USWC pricing flexibility for its intraLATA toll services. First, USWC proposes flexible pricing for its intraLATA toll services. USWC's position is reflected in its stipulations with MCC and AT&T. The USWC/AT&T stipulation states that the parties agree with a "banded rate flexibility" which includes the following: (1) maximum toll rate flexibility with price ceilings set at the levels in place at the conclusion of this proceeding; (2) downward rate flexibility to the price floor upon seven days notice to the PSC; and (3) cost imputation analysis according to the formula established in this proceeding to establish the price floor for toll services (Exh. USWC-30, pp. 5-6).

259. The USWC/MCC stipulation includes the following section:

The MTS pricing proposal will be amended, however, to ask that the PSC approve maximum



rate treatment for the MTS rates in place at the conclusion of this case, as well as the ability for USWC to change rates on ten day's notice to the PSC, ..... this proposed treatment is consistent with the AT&T stipulation, paragraph 16.

260. In its brief, USWC states that downward pricing flexibility would benefit toll service customers. USWC reminds the Commission that today's toll service market is competitive, and thus the Commission should authorize USWC to price its services in a manner which allows it to participate in competition (USWC Brief, p. 26). USWC further states that as long as its prices exceed relevant price floors, its competitors have no legitimate complaint about price competition. The Company believes that price inflexibility handicaps its ability to compete and also prevents its customers from receiving lower prices (USWC Brief, p. 28).

261. In its stipulation with USWC, AT&T agrees that USWC should be permitted pricing flexibility for its intraLATA toll services. In its brief, AT&T submits that USWC should not be granted any pricing flexibility for its toll services unless all of its incremental costs are included in determining the price floor for each service in imputation. The specific item AT&T focuses on includes all of the ILEC originating access service charges USWC paid. AT&T advises rejecting pricing flexibility for any of its intraLATA services, if the Commission does not require USWC to include ILEC originating costs in its imputation formula (AT&T Brief, pp. 20-21).

262. MCI opposes pricing flexibility for the Company's toll services. According to MCI, without the implementation of 1 plus dialing parity, the toll market is not sufficiently competitive. MCI believes that because of USWC's monopoly power in 1 plus intraLATA toll service market, the Commission cannot grant USWC any toll pricing flexibility. MCI adds that IntraLATA 1 plus dialing parity and presubscription is a necessary prerequisite to encourage competition in USWC's intraLATA toll service market. Thus, the Commission should not grant USWC toll pricing

flexibility for its services in this substantial monopoly market unless 1 plus intraLATA equal access exists. MCI does not believe USWC faces competitive pressure absent 1 plus intraLATA dialing parity.

263. Importantly, MCI's brief echoed its prior testimony that USWC's customers suffer from "inertia" in their unwillingness to subscribe to other than USWC's services and that speed dialers fail to provide economically equivalent substitutes to USWC's services (MCI Initial Brief, dated September 1, 1992, pp. 5-14). Thus, MCI concludes dialing parity is non-existent in the intraLATA market, and USWC is not subject to effective competition due to its captive customer base.

264. Second, MCI claims that without the implementation of 1 plus equal access, toll pricing flexibility will not be in the public interest because Montana customers will continue to be precluded from meaningful access to other carriers (MCI Brief, pp. 2-4).

#### Commission Decision: Pricing Flexibility for USWC's Toll Services

265. The Commission approves USWC's proposal to price its toll services on a flexible basis. This approval allows USWC to price its intraLATA toll services, including MTS, WATS, 800 Service and some other toll-type services, similar to how other IXC's can price in Montana. The price floor for USWC's intraLATA toll services must reflect relevant imputations, ILEC originating charges to USWC, and LRICs. The price ceiling for each toll service is determined by the Commission at the end of this Docket. The Commission finds that once USWC lowers a toll service price, residential or business, USWC cannot raise the rate without the Commission's approval. In other words, a ratchet exists in USWC's pricing flexibility: prices are only flexible downward.

266. Several reasons support for the Commission's approval of pricing flexibility for USWC's toll services. First, the Commission agrees with the MCC, that it is only clear that the business toll service market is sufficiently competitive (MCC Brief, September 1, 1992). Second, the Commission finds that

downward pricing flexibility for USWC will provide the possibility for Montana customers to have lower rates than the current ones. The Commission recognizes MCI's concern for granting USWC pricing flexibility absent 1 plus intraLATA equal access. However, the Commission prefers to treat the 1 plus equal access issue in a separate docket, instead of considering its decision on toll pricing flexibility on a bundled basis.

#### Forbearance Filing Rule

267. USWC's witness, Mr. Rees, recommends affording USWC relaxed forbearance available to AT&T, MCI and other IXC's. Relaxed forbearance automatically grants approval one day after an IXC's application is filed with the Commission. In contrast, the forbearance rules which apply to USWC, require the Company to show a viable competitive offer exists. Under this current rule, the Commission has 15 days to determine whether a viable competitive offer exists. USWC asserts that the current forbearance process puts the Company at a competitive disadvantage when dealing with a customer with alternative toll service proposals. USWC complains that its largest competitors, on the other hand, operate with a relaxed forbearance procedure and are able to respond to customers after a one day period.

268. Several parties testified on the merit of USWC's request. Neither MCC nor AT&T object to USWC's request for relaxed forbearance.

269. MCI does not object to relaxed forbearance for USWC subject to the following conditions. First, MCI points out that any USWC contract pricing should meet both an unbundling and an imputation standard. MCI argues that bundling of monopoly and competitive services must be prohibited, and any contract must meet an imputation test which should include ILEC originating charges to USWC. In this regard, MCI also expressed concern about discriminatory pricing and whether the services in USWC forbearance contracts are also available to USWC's competitors, such as MCI.

#### Commission Decision: Forbearance Filing Rule for USWC

270. The Commission grants USWC's request for a relaxed

forbearance filing process which was previously granted USWC's competitors in the recent OCC Docket. Ordering paragraph 3 (pp. 14-15) of Order No. 5548b in Docket No. 88.11.49 is hereby incorporated herein by this reference.

271. For clarification purposes, forbearance of regulation is a statutory procedure by which a provider of regulated telecommunications service obtains authority to make a non-tariffed price proposal to a specific customer. Relaxed forbearance is an expedited version of this statutory process. Under relaxed forbearance, approval is automatic one day after the application from USWC is completed.

272. The Commission's approval of relaxed forbearance for USWC is subject to the following conditions. First, any pricing included in USWC special contracts has to meet the imputation standard. The imputation standard or test is that contained in USWC's imputation stipulation with AT&T and MCI. Forbearance contract prices offered by USWC may not go below the relevant imputation price floor. Second, the approval of the relaxed forbearance also requires that any volume discounts in forbearance contracts have to meet an imputation test. Third, the ILEC originating charges to USWC in I-B type toll services must be included in the imputation test.

#### General Rate Design

273. The following presents the parties' positions on the USWC primary rate design proposals in this Docket. USWC stipulated with MCC in this filing regarding the primary rate design proposals. The first stipulation was filed on March 25, 1992, and the second on May 29, 1992. The first stipulation includes primary and secondary rate design proposals. The primary rate proposals reduce USWC's revenue by the amount of \$6,116,948 annually. The second proposal achieves additional revenue reduction of \$3,686,052, making the total revenue reduction of \$9,803,000 annually for USWC. The second stipulation slightly revised the first stipulation. The annual revenue reduction in the second stipulation after the revisions is \$6,185,948.

274. AT&T and MCI commented on the above primary rate design

proposals. First, AT&T has no objection except for a concern with the OCC discount, which was discussed in a previous section. Second, MCI's concerns with the primary rate design proposal included billing information in rate design, the elimination of LS1/LS2 rate disparity, the elimination of rate discount for OCCs, and the pricing flexibility for USWC's toll services. All of these issues also were previously discussed in this Order.

#### Commission Decision: General Rate Design

275. The Commission approves the primary rate design proposals in the final USWC stipulation with the MCC. There are three reasons the Commission approves of the primary rate design in the stipulation. The first is the elimination of touchtone charges with an associated \$2.661 million revenue reduction impact. The Commission believes that the elimination of this charge follows the cost realities of new switching equipment. By approving the elimination of touchtone charges, ratepayers will be able to take advantage of the new equipment, and both residential and business customers will benefit from this rate change. The second important primary rate design change is the elimination of two-party service with its associated revenue increase of \$345,516. The Commission agrees with USWC and MCC on this account that newer equipment is incompatible with two-party service. If USWC was required by the Commission to maintain two-party service, additional costs would be incurred. The incurred cost on the upgraded network system to maintain out-of-fashioned two-party service would be uneconomic and inefficient for Montana customers overall. The third is the reduction of zone charges, with its separate and significant \$3.37 million revenue decrease. The Commission finds that despite the continuation of cross subsidies in the USWC proposal, USWC's proposal is in the public interest.

#### Late Payment Charge

276. The following section addresses the issue of USWC's Late Payment Charge (LPC) proposal. As background, in Order No. 5354a the Commission approved a 1 percent per month Late Payment

Charge for customers whose bills exceeded \$25. The \$25 threshold was requested by USWC at the time. In Docket No. 90.12.86, the Commission raised the issue of whether the \$25 threshold should be increased.

277. Of the parties, only USWC (Ms. Owen) expressed any concern about this issue. USWC believes the LPC is not negatively impacting customers. USWC believes that a LPC guarantees that those causing an expense are also the ones to incur that expense. USWC had no comment on whether the Commission should raise the \$25 threshold.

#### Commission Decision: Late Payment Charge

278. The Commission finds merit in raising the LPC threshold from \$25 to \$45. According to USWC, the revenue impact (loss) based on this change would be about \$51,000 per year. The Commission believes the \$45 LPC represents a more reasonable threshold that will better serve the consuming public.

#### ISDN Pricing

279. In an interim Order No. 5468, issued on March 27, 1990, the Commission allowed USWC to price ISDN services on an Individual Case Basis (ICB). ICB pricing for ISDN services was initially proposed by USWC in Docket No. 89.8.35 and later rolled into Docket No. 90.12.86 for further consideration. By implementation of ICB pricing, USWC proposes that there be no specific tariff prices. Under this approach USWC will determine the incremental cost of providing ISDN service to each customer. In other words, the prices offered by USWC to each customer who orders ISDN service will be customer specific. According to USWC there are three situations which need to be considered in pricing ISDN services: distance from the serving central office, whether or not the customer's local loop is "loop qualified" for ISDN, and whether or not the serving central office is equipped to provide ISDN.

280. Both AT&T and MCI commented on the merits of ICB pricing for ISDN services. AT&T opposes ICB pricing for ISDN services. AT&T generally believes that the ICB pricing under

which USWC provides ISDN services will unduly restrict customers' plans to use the service and thus, unnecessarily restricts development of the ISDN market (AT&T Brief, p. 28). AT&T states that because USWC's ISDN tariff only offers ISDN service on an ICB, each customer request is "priced-out" separately. Thus, ICB pricing in practice will only allow large customers to subscribe to ISDN services, but not residence and small-size business customers (AT&T Brief, p. 28). As a result, AT&T suggests that USWC offer a general tariff for ISDN service so that all customers, including interexchange carriers, can subscribe to the service.

281. MCI recommended the rejection of USWC's ICB pricing proposal for ISDN services. MCI supports AT&T's recommendation that USWC should file a general tariff for ISDN services so that all local exchange customers can subscribe to the service. MCI also states that USWC should include identical local exchange ISDN services and features in its carrier access tariffs so that IXC carriers can provide interLATA ISDN services.

#### Commission Decision: Pricing for ISDN Service

282. The Commission will approve the pricing of ISDN on a contract approval basis, a modification of USWC's ICB proposal. All ISDN contracts must be filed with and approved by the Commission before service is provided. The request for a general ISDN tariff, made by AT&T and MCI, is denied.

283. The approval of ISDN service is subject to the following conditions. First, an imputation methodology must be performed to determine USWC's contract pricing for its ISDN customers and all ISDN contract prices must exceed their relevant LRICs to prevent uneconomic competition occurring in this market. Second, rates developed by USWC for ISDN service must be based on an apportioned LRIC. The apportioned LRIC should be based on reasonable forecasts of demand in this market. The Commission believes that once USWC equips a Central Office with ISDN technology, there will be additional customers beyond the first customer served. Thus, it is reasonable and efficient to apportion the setup costs. This approach of cost apportioning will encourage more ISDN demands, and thus encourage USWC to make

a fuller use of existing ISDN facilities. Third, USWC must submit to the Commission all costing information, imputation analysis and the proposed contract prices for the Commission's approval before ISDN prices go into effect. The Commission's approval of contract approval pricing for USWC's ISDN service will have no bearing on the Commission's decisions in any future proceedings. The Commission reminds USWC that it may require USWC to establish a general tariff for ISDN service whenever the Commission believes that USWC has gained adequate information and experience in this market.

#### DSS Pricing

284. On June 5, 1990, the Commission issued Order No. 5477, Docket No. 90.5.32, approving USWC's request to price its Digital Switched Service (DSS) on an interim basis. DSS service was consolidated with Docket No. 90.12.86 for the Commission's further consideration. According to USWC, DSS provides digital exchange service for Private Branch Exchange (PBX) customers. The DSS service includes a Digital Switching 1 channel facility, common equipment, local exchange switching and flat rated trunks to allow PBX customers to access to the local and toll exchange networks. USWC explains that it is appropriate to price DSS configurations on an ICB basis since the cost of this service, e.g. fiber optic and installations, will vary depending on each customer's specific situation.

#### Commission Decision: Pricing for DSS Service

285. The Commission approves USWC's proposal to price its Digital Switch Service on a contract approval basis, a modification of USWC's ICB proposal. The Commission's approval is based on the recognition that USWC has not met enough market demand for DSS service to establish a general tariff for all Montana customers.

286. USWC must satisfy the same conditions for DSS as described in Findings of Fact Nos. 282-283 with respect to ISDN contract approval. Contract prices must be approved by the Commission before prices go into effect.

287. The Commission's approval of contract approval pricing



for USWC's DSS service has no bearing on the Commission's decisions in any future proceedings.

Commission Decision: ONA

288. At a worksession on April 8, 1992, the Commission elected to defer further consideration of ONA in this Docket. The ONA issues raised by the parties are now being considered by the Commission in Docket No. 92.6.28.

Customer Bill Format

289. USWC's customer bill format was identified by the Commission as an additional issue in this Docket. The Commission finds that neither the bill currently used by USWC nor its customer bill "prototype" that was included as an exhibit in USWC witness Mary Owen's testimony effectively communicates billing information to customers. USWC's customers would be better served if USWC's considerable public relations resources were challenged to use modern communications techniques to produce a plain-language, easy-to-read, user-friendly bill. The Commission believes a company whose business is communication should certainly be able to communicate better with its customers in its monthly bills.

290. USWC's bill identifies for customers "basic" and "optional" services. The Commission finds that this is useful information for customers, but notes that the determination of which services are basic or not is the company's own; the Commission has not defined what constitutes basic or optional services.

291. The Commission finds that USWC is not complying with ARM 38.5.3332(1)(b)(iv), which states customer bills must clearly provide "a statement that regulated services may not be disconnected for nonpayment of nonregulated services or services provided by other carriers, except for other carriers' regulated services that cannot be disconnected or discontinued separate from local service." There are two areas of noncompliance: 1) the statement currently in use on customer bills is written so poorly that its meaning is unclear, and it has not been amended

to add that regulated service provided by USWC will not be disconnected for nonpayment of service provided by other carriers; and 2) USWC does not include the statement on all customer bills as required by the rule, but only on those bills which contain nonregulated charges. The Commission directs USWC to comply with the rule.

#### Objections to Introduction of Staff Data Requests

292. USWC raised an objection to the introduction of the responses to staff Data Requests in this Docket: "(I) would object to the use of staff data requests; and rather than outline my basis, I will simply say it's the due process issues as outlined extensively in Docket 90.7.44." Transcript, April 17, 1992, p. 75.

293. The Commission notes that USWC signed a Waiver in this Docket, which provides in pertinent part as follows:

U S WEST Communications, Inc., a formal party in the above captioned administrative proceeding, hereby waives the following objections to the introduction or admission of all Data Requests submitted by the Commission staff to any and all parties, and the parties' responses thereto, into the administrative record in this proceeding, or in related judicial proceedings. This waiver includes any and all objections, motions or other legal recourse, by the above-named party, at any time whatsoever, requesting the Commission, a court or other body to strike or exclude from the record any portion whatsoever of said Data Requests and Responses. With the exceptions noted below, this waiver shall include any and all objections based upon the Montana Rules of Evidence and all other statutory and common law rules of evidence. This waiver shall not preclude any party from raising an objection based upon relevance (M.R.E., Rule 401) or

upon the Due Process Clauses of the United States and Montana Constitutions. (Footnote omitted)

Waiver of Evidentiary Objections, signed March 24, 1992.

294. Based upon this Waiver, USWC is precluded from raising any objection based upon the Montana Rules of Evidence, except relevance. USWC has not raised any objection to the relevance of any Data Response herein.

295. USWC's objection is based upon "the due process issues as outlined extensively in Docket 90.7.44." USWC did not file a Brief on "due process issues" in this Docket. The Commission has previously addressed objections to the introduction of responses to staff Data Requests, and overruled those objections. The Commission adopts by reference herein paragraphs 8-23 of Order No. 5399b in MDU Docket No. 88.11.53, and paragraphs 15-20 of Order No. 5484k in MPC Docket No. 90.6.39, as its response to USWC's objection in this Docket. Staff introduction of evidence is clearly permitted by Section 69-2-102, MCA, ARM 38.2.601(n) and 38.2.3902(1).

296. The Commission finds that USWC has provided no reason why a ruling on these objections should differ from previous rulings on similar objections. Therefore, USWC's objection to staff introduction of evidence is overruled, and all responses to all staff Data Requests are admitted into the record. Further, responses to Montana Consumer Counsel Data Request Nos. 270, 271, 272, 274, 297, 328, 329, 330 and 418 through 422, are admitted.

297. The Commission is considering potential prospective changes to its staff structure in conjunction with fairness, due process, and procedural issues in Docket No. 90.7.44. The Commission will issue a decision in that separate Docket, but will not express any opinion on it here.

#### CONCLUSIONS OF LAW

1. USWC provides regulated telecommunications services within the State of Montana, Section 69-3-803, MCA, and is a regulated public utility pursuant to Montana law. Section 69-3-

101, MCA

2. USWC is subject to the jurisdiction, supervision and control of the Montana Public Service Commission. Section 69-2-102, MCA

3. The PSC has provided adequate public notice and an opportunity to be heard herein, pursuant to the Montana Administrative Procedures Act. Title 2, Chapter 4, MCA

4. The revenue requirement, rate design and rate levels approved in this Order are just, reasonable, nondiscriminatory; and consistent with the applicable provisions of the Montana Telecommunications Act. Sections 69-3-201, 69-3-330, and 69-3-801, et. seq. MCA

5. The imputation methodology, cost of service methodology and price floors approved herein are consistent with the requirements of the Montana Telecommunications Act. Section 69-3-811, MCA

6. Independent Local Exchange Access Charges are "relevant costs" for purposes of calculating proper toll rate price floors. Section 69-3-811, MCA

7. The toll flexibility (downward only) granted USWC herein is based upon and consistent with the standards and purposes of the Montana Telecommunications Act. Sections 69-3-807 and 69-3-802, MCA

8. The original USWC proposal for individual case based pricing is not consistent with the Montana filed rate statute. Sections 69-3-301 and 69-3-305. However, the contract approval pricing method approved herein is consistent with these statutes.

#### ORDER

IT IS HEREBY ORDERED that:

1. The revenue requirement, rate design and revenue levels of USWC, as modified herein, are hereby approved.

2. The Commission Decisions contained in Findings of Fact Nos. 50-53, 66-84, 95, 98, 129, 141, 142, 144-150, 153-155, 161, 162, 164, 165, 170-174, 178, 179, 181-184, 187-191, 229-243, 249, 254, 257, 265, 266, 270, 272, 275, 278, 282, 283, 285, 286, 288, 289-291, 295, and 296 above are hereby ordered, and incorporated

herein by this reference.

3. USWC is ordered to file compliance tariffs with the Commission within twenty (20) days from the service date of this Order, which incorporate all of the decisions herein. Copies of all compliance tariffs must also be served by USWC on all intervenors. Authority to review and approve the compliance tariffs is hereby delegated to the Commission staff. The compliance tariffs will be reviewed and subject to approval by staff, with an appropriate subsequent effective date.

4. The Commission hereby orders USWC to provide workpapers that document the credits received by customers due to the \$6.14 million revenue reduction.

DONE AND DATED at Helena, Montana, this 23rd day of November, 1992, by a 4 to 1 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

s/DANNY OBERG, Chairman  
s/WALLACE W. "WALLY" MERCER, Vice Chairman  
s/BOB ANDERSON, Commissioner  
(Concurring and Dissenting-Written  
Opinion Attached)  
s/JOHN B. DRISCOLL, Commissioner  
(Voting to Dissent-No Dissent Attached)  
s/TED C. MACY, Commissioner

ATTEST:

Kathlene M. Anderson  
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.4806, ARM.

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Department of Public Service Regulation  
Before the Public Service Commission  
of the State of Montana

\* \* \* \* \*

In the matter of the application	)	Utility Division
of U S West Communications for	)	
approval of an alternative form of	)	Docket No. 90.12.86
regulation	)	

Dissent of  
Commissioner Bob Anderson  
On Order No. 5535G

Beginning at FOF 54, Order No 5535g approves USWC's proposal to change from a pay-as-you-go method to an accrual method for future medical benefits for current employees. The revenue requirement of this change is \$3.946 million per year. This approval is wrong for the following reasons.

Uncertainty of projections of future costs. The accrual amounts depend on estimates of future costs and their rate of increase. These estimates are speculative. Indeed, the revenue requirement effect was revised several times in the course of this case.

Risk shift. Charging current ratepayers for these future costs places the risk of cost increases solely on ratepayers. Shareholders should share this risk.

Lack of incentive for cost containment. One of American society's most perplexing problems is the rapid increase in the cost of health care, partially due to the lack of accountability for cost containment. Charging today's ratepayers for future medical expenses of USWC employees would limit the incentive management would have to control these costs. This approval will require all future commissions to be especially vigilant with respect to medical benefits.

#### CONCLUSION

The Commission should allow only a portion of future medical expenses of USWC employees to be charged to current ratepayers in order to equitably share the risk of these future costs between shareholders and ratepayers and between this generation and the next.

s/Bob Anderson, Commissioner

Matter of Application of U.S. West Communications  
Decided Nov. 4, 1991

Service Date: November 4, 1991



DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

\* \* \* \* \*

IN THE MATTER OF the Application) UTILITY DIVISION  
of U S West Communications RE: )  
Montana Network Improvement and ) DOCKET NO. 90.12.86  
Rate Stability Plan and Cost of )  
Service/Rate Design. ) ORDER NO. 5535c

ORDER IDENTIFYING ADDITIONAL ISSUES

Background

1. The Commission has identified several additional issues in Docket No. 90.12.86. The Commission finds that these issues should be addressed by U S West Communications (USWC), as well as by other interested parties by filing written testimony pursuant to the currently effective procedural schedule.

Additional Issues

Percentage Interstate Usage (PIU)

2. The response to PSC Audit Request No. 31 stated: "The U S WEST internal audit department has not performed any audits on reported intrastate minutes for other carriers." During the OCC hearing in Docket No. 88.11.49, it was noted that intrastate access charges are higher than interstate access charges. Given the fact that it is less costly to pay interstate access charges, it is vital that reported PIUs are accurate. Understated intrastate minutes could cause several problems, two of which are understated USWC carrier access revenues and encouragement of anti-competitive behavior in the intrastate toll market.

3. Parties should comment on how the issue of PIUs should be

resolved in terms of the revenue requirement effect in this case and all future cases. Also, how to ensure that PIUs are properly reported by each participant in the intrastate toll market. Should USWC conduct audits on all carriers prior to the hearing in this docket (as well as annual audits in future years) and reflect the increased carrier access revenues if any result? If it is determined that insufficient time exists to perform such audits prior to the hearing, should the Commission impute additional carrier access revenues? If this course of action is proposed by a party, the imputation should be based on supportable evidence.

4. Dr. Zahn, on behalf of AT&T, believes that each inter-exchange carrier's and reseller's PIU reports should be validated by an audit process and he proposed tariff language in this regard (response to PSC-254b). USWC must address both AT&T's concern and its proposed tariff language. The data reports forthcoming would also provide the Commission useful market share data.

#### Directory Revenues

5. USWC included a revenue requirement reduction of \$3,983,000 to reflect excess profits associated with U S WEST Direct. MCC witness David Kirby makes two adjustments to the Company's proposed adjustment: (1) use of the 9.75% overall rate of return recommended by MCC witness Dr. Wilson; and, (2) imputation to directory investment the capital structure which includes 50% debt, which created a tax benefit for an interest deduction which was not reflected in the Company's tax calculation. Neither party's proposal permanently solves this controversial issue. The Commission asks all parties to put forward their proposals in testimony for a permanent solution to the issue of directory revenues. The basis for the solution should include a sharing of directory revenues between USWC and its ratepayers based upon a percentage split. This is an important difference from accepting a fixed dollar amount as is currently proposed due to the fact that these revenues grow each year.

#### Standards for New Service Offerings

6. It is often claimed by proponents of new regulatory regimes for telephone companies that more freedom is needed to allow companies to become more efficient in the face of increasing competition. Historically, when new products are developed, they are first trialed in test markets, and then deployed in large urban areas, next in mid-size towns, and last in rural areas like Montana. This pattern has been repeated time and time again, with Montana being at the end of the cycle for new product and service introductions. It is important to note that for the last couple of years USWC has earned at or over its authorized rate of return. In spite of that, the pace of new products and services being introduced is extremely modest. There are a number of new and interesting products and services which will be developed in the near term. However, if history is any indication, those products will not be seen in Montana for some time to come. Parties are requested to testify on the desirability of establishing a standard which would require a certain number of new products and services to be introduced in Montana as a requirement for instituting a Rate Stability Plan. Parties' proposals should be specific regarding proposed standards and how to measure USWC's performance relative to those standards.

#### 1+ Intralata Equal Access Capability

7. In a December 17, 1990, letter to Chairman Ellis, Mr. Ruff estimated a \$7,500 cost per office to upgrade the Ericcson Switches for 1+ intralata equal access capability. In his letter, Mr. Ruff stated that the generic upgrade with this feature is scheduled for release during the 3rd quarter in 1992.

8. In passing the 1985 Montana Telecommunications Act, the legislature defined the purpose of the act as follows:

The legislature declares that it remains the policy of the state of Montana to maintain universal availability of basic telecommunications service at affordable rates. To the extent that it is consistent with maintaining universal service, it

is further the policy of this state to encourage competition in the telecommunications industry, thereby allowing access by the public to resulting rapid advances in telecommunications technology. It is the purpose of this part to provide a regulatory framework that will allow an orderly transition from a regulated telecommunications industry to a competitive market environment. (Sec. 69-3-802, MCA)

9. Given this clear statement of policy and purpose, the Commission would like parties in this proceeding to comment on the desirability of including in USWC's proposed network modernization program the necessary investments to allow 1+ intralata equal access capability. Testimony on this issue should focus on the effect 1+ intralata equal access capability would have on universal service, and whether this would be a proper avenue to encourage competition.

10. Additionally, USWC must further identify the total costs to upgrade the network for 1+ intralata equal access capability. For instance, will all of the switches listed in Mr. Hayhurst's Sch. 2, Attachment A require the \$7,500 upgrade or will an upgrade at each host provide 1+ intralata equal access capability at all connected remotes?

#### Impact of Montana's Decision Regarding the RSP

11. Many of the states in which USWC operates have approved or are considering approving some form of alternative regulation in order to encourage efficiency and innovation. Given the tendency of other states regulating USWC to adopt alternative regulation plans and given the small size of USWC's Montana operations in relation to the Company's entire operations, the Commission would like to know what impact Montana's decision on the proposed RSP could have on the Company's overall incentives to be innovative and operate efficiently.

12. If the majority of states in USWC's service territory opt for alternative regulation and this creates additional incentives

for the Company to be efficient and innovative, won't those efficiencies and innovations automatically inure to USWC's Montana ratepayers without this Commission adopting alternative regulation?

13. Alternatively, what are the detriments to USWC's Montana ratepayers if the RSP or some other form of alternative regulation is not adopted by the Commission.

#### Telephone Service Quality

14. The Commission is charged with ensuring that regulated utilities provide customers with adequate service. If USWC's "Rate Stability Plan" is approved, there will be incentives for the company to cut costs through achieving operational efficiencies. Naturally, the Commission would not want service quality to deteriorate as a result of any cost-cutting efforts the company might undertake.

15. The Commission invites all parties in this proceeding to comment on whether the RSP should include incentives for USWC to maintain or improve existing service levels by requiring service quality objectives to be met before the company can share in excess earnings above whatever rate of return might be authorized. The Commission encourages parties to provide their specific ideas on this subject, including, for instance: what service objectives are the best indicators of company performance; how to measure and monitor service quality; and, how best to reward the company for improved service quality and penalize decreased service quality.

16. Following for the parties' information are summaries of alternative regulation plans proposed or approved by other states where phone companies' share of excess earnings depends in some manner on maintaining or improving service quality:

Alabama - The amount of excess earnings South Central Bell retains above the authorized return on equity is based on the company's performance in the areas of service quality and cost controls. Held orders and customer trouble reports are the

indicators used to measure service quality.

Connecticut - Southern New England Telephone's approved incentive regulation plan provides that the company is allowed to share in excess earnings only if trouble reports do not exceed 2.5 reports per hundred access lines.

Georgia - Southern Bell is not allowed to share excess earnings if any exchange fails the trouble report standard of 5 reports per 100 access lines.

Louisiana - South Central Bell has proposed an incentive regulation plan in which sharing percentages would be determined in part by service quality measures.

New York - Rochester Telephone's approved regulatory incentive plan includes a provision for customer rebates if company's service quality slips.

Tennessee - Under the state's generic regulatory reform plan, participating large local exchange carriers' share of excess earnings is based on the company's level of service.

Companies are required to report annually regarding: Commission complaints; installation appointments met; held orders; trouble reports; repair time; and overall customer satisfaction.

Utah - The Utah Division of Public Utilities recently proposed an incentive regulation plan for USWC in which the company's share of revenues under could be adjusted based on changes in service performance and service quality as reported annually. Service quality would be measured by the results of USWC's annual survey of Utah customers in which customers grade the company from A+ (excellent) to F (bad). Each year's composite survey percentage of A+/A grades would become the mid-point of a neutral range for the next year. The neutral range would be a range of 4% in which USWC and ratepayers would share earnings equally. If the composite percentage in any year

exceeds the neutral range (2.1% above the mid-point), that year's shared earnings would be distributed 54% to USWC and 46% to ratepayers. Conversely, if the composite survey percentage of A+/A grades is below the neutral range, that year's shared earnings would be split 46% to USWC and 54% to ratepayers. In addition, a bonus or penalty would be assessed for the company's held order performance. USWC turned down the DPU's incentive regulation proposal.

Vermont - Under the Vermont Telecommunications Agreement which eliminated traditional rate of return regulation for New England Telephone, the company agreed, among other things, to maintain its quality of service in accordance with specific criteria.

#### Optimal Modernization Plans

17. During the hearing in Docket No. 90.12.86, the Commission will schedule one day for public testimony on what constitutes an optimal modernization plan for the state of Montana. Witnesses from all areas of society are invited to attend and provide their input. The Commission desires the broadest participation possible to ensure Montanans are provided with all of the telecommunications services they require.

18. One of the most serious concerns the Commission will raise involves the dearth of testimony and evidence on USWC's modernization plans and the relation of these plans to the balance of the AFOR Plan. USWC's plans would convert the existing system (switching and interoffice facilities) into a state-of-the-art digital system at roughly a \$91 million price tag. The Commission firmly believes the record is inadequately developed in this regard. "State-of-the-art digital" and "\$91 million dollars" are too simple of summary statements for the impacts the Plan will have on Montana ratepayers.

19. First, the Commission requests USWC to testify about its vision of the optimal telecommunications system for Montana by

2000, considering all forms of telecommunication available by that time. Second, the Commission requests USWC to describe the portion of such an optimally integrated telecommunications system that should be provided by traditional "telephone companies," including itself and any competitors. What are the forecast sales of new ("new" per HB 610-5-(3)) and existing products and services? Describe each and every new service offering USWC expects to provide. Third, the Commission requests USWC to testify about how it decided on the modernization it wishes to initiate, and on the level of investment. Since all regional Bell companies, including USWC, are already planning to replace much of their copper wire with fiber over the next two decades, why is no fiber, including fiber to the home, included in this Montana "modernization" program? How is the modernization strategy and level of effort driven by unmaterialized demands? How did USWC model risk and uncertainty? Finally, will the October 24, 1991, (5-0) decision of the Federal Communications Commission to allow local telephone companies to package and transmit television programming, change the presently proposed "modernization" strategy? What role does USWC see the Commission playing in this decision?

20. In addition to the above general questions, the Commission is interested in and requests USWC to testify on whether its modernization plans will overcome any pre-existing technological barriers to the innovation of certain new product applications. While the Commission will only focus on two applications, USWC should feel free to augment these items to address other applications. The first application involves whether the USWC modernized system will permit other Montana utilities to use the system for meter reading purposes. For example, would MPC be able to interconnect its gas and electric meters to the USWC modernized system for meter reading purposes? How does USWC's plan account for such applications whether they be gas, electric or water meters?

21. A second application involves whether the modernized system would allow a gas or electric utility to use USWC's system for load management purposes. By load management the Commission



means load control via remote signaling. For example, would MPC in Butte, be able to remotely control the load of a customer, in Helena, by means of signaling over the USWC communications system?

22. Finally, as regards applications, the Commission is keenly interested in, and requests USWC to testify on, nontechnological barriers that would inhibit or prevent USWC from marketing the above general and two specific product applications.

#### Relevant Cost Studies and Cost Recovery Methods

23. Aside from the issue of what constitutes an optimally modernized system, there arises the question of who should pay for such a system. The continuum of cost recovery philosophies includes cost causer and social equity concerns. Each is discussed in turn.

24. Cost causer arguments to recover the costs of a modernized system involve cost-of-service studies. To generalize, such studies are typically embedded or some form of incremental cost study. Among the numerous costing proposals in this docket are USWC's long-run incremental cost (LRIC), and AT&T and MCI's interest in a building-block based LRICs.

25. To this partial list, MCC's witnesses raised numerous cost study approaches. Mr. Buckalew's testimony mentions a number of different cost-of-service studies between pages 32 and 39 of his September testimony which include: "annual cost analysis for service categories" (p. 32), "CAS" (p. 32), "embedded direct cost analysis on an annual basis" (p. 32), "marginal costs" (p. 33), "loop is a loop" (pp. 32-33) and "category cost analysis" (p. 34).

While Dr. Wilson raised the concept of "total factor productivity" (at page 57), Mr. Buckalew actually asserts the Commission ought to think about the merit of a total factor productivity study in this docket (p. 38).

26. The Commission requests USWC to explain its understanding of the nature (embedded, incremental or other) and relation between

these studies and recommend which of these it agrees can and should be provided on an annual basis per MCC's recommendation. The Commission also requests USWC to state its opinion on the relevant purpose (i.e., allocation of costs between regulated and deregulated services and pricing of any regulated service) of each cost study. As a point of clarity, the Commission is not ordering USWC to perform any of the cost studies listed by Mr. Buckalew; however, an ultimate Commission decision may impose such a requirement. Rather, the Commission believes USWC is the natural source of an explanation of the nature and relation of these various studies. Any other intervening party can, in turn, address the same Commission concerns. MCC may want to clarify its own testimony in this regard.

27. As noted above, the Commission also has interest in and requests USWC to testify on the social equity impacts of telephone modernization. In this regard, and aside from the above cost causer mechanisms of cost recovery, if telephone modernization is an economic development issue, why shouldn't society (through taxes) pay for the costs of a modernized telephone system? That is, why shouldn't the people who benefit from modernization pay the costs via taxing authorities and/or rate design?

#### Rate Stability in a Deflationary Environment Concerns

28. Dr. Wilson tied USWC's testimony to freeze prices to his apparent belief that the industry environment is in either a declining cost (p. 52) or deflationary state (pp. 59, 61). With this premise, Dr. Wilson concludes that fixing rates for monopoly services, coupled with allowing flexible pricing for competitive services, will inhibit efficiency and productivity advancements. Dr. Wilson then recommends that all excess profit refunds (actually reduced rates) should be given only to fixed rate customers.

29. In light of Dr. Wilson's premise, conclusion and policy recommendation, the Commission requests USWC to address which services should be included in Dr. Wilson's "fixed rate customer" group, if adopted by the Commission. The Commission is

particularly interested in how USWC views the relation of Dr. Wilson's fixed rate customer group to the category and list of basic (and related) exchange services in Mr. Hayhurst's Schedule C (December 1990).

#### Imputation or Inclusion of Relevant Costs

30. Imputation is the principle of including the prices for a monopoly service in the prices for a competitive service. The asserted purpose of imputation is to mitigate a price squeeze. Two parties (AT&T and MCI) raised a number of imputation or cost inclusion concerns in their direct testimony. First, Dr. Zahn's (AT&T) concerns include: 1) USWC excludes the incremental costs of its intraLATA toll service paid Independent Companies (p. 28-29); 2) access and billing charges paid ILECs must be included (p. 30); 3) USWC's price floors for non-basic services should reflect average incremental costs, adjusted for relevant imputations; 4) imputation should include public access line (PAL) service; and, 5) any non-basic service that uses an ONA offering as a component must be imputed (p. 46). Second, Mr. Dittirro (MCI) added that price squeeze concerns are not limited to toll and include special access, local area networks and payphones (pp.37-38).

31. Whereas the Commission is not requesting USWC to address the above issues, the Company may of course do so if it chooses. However, in data responses AT&T augmented its testimony to specify imputation tests and methods, and addressed procedural mechanisms to resolve its concerns. In this regard, the Commission requests USWC to address AT&T's data responses numbered PSC-248-c, 250-c, - 253-c, - 257-e and -258.

#### The Impact of Alternative Costing Methods on USWC's AFOR

32. As background, USWC proposed price floors based on long-run incremental costs (LRIC). Whereas AT&T and MCI support LRICs, they prefer an approach which is modified to reflect "building-blocks." MCI also discussed a five-step process to determine price floors involving a workshop process similar to Oregon's (pp.45-51).

While silent on a building-blocks approach, Dr. Greer (MCC) believes LRICs should be used at such time as USWC's market share is sufficiently eroded.

33. Once more, the Commission leaves to USWC and other parties the option of addressing the above issues in their respective rebuttal testimony. Again, however, additional issues arose involving this topic but out of data responses. The Commission requests USWC to address the following issues raised in data responses. First, the Commission requests USWC to address both AT&T's proposal that USWC replace its current LRIC studies with a building-blocks approach at the conclusion of the Oregon workshop process (AT&T Data Response PSC-261) and, in contrast, MCI's proposal that the building-blocks approach be implemented prior to the Commission's approval of any incentive regulation (MCI Data Response PSC-262-c).

34. Second, the Commission inquired as to USWC's opinion on the merit of the Oregon workshop approach to develop LRICs (PSC-065). USWC's response, in part, was that it would support any process that is geared toward a full discussion of the relevant methods and procedures that should be utilized when conducting a cost study, adding that any process that reduces the issues in a formal regulatory proceeding would be most welcome.

35. While the Oregon workshop approach and cost methods are by no means a fait accompli in the present docket, the Commission requests USWC to expand on its response. To avoid numerous "what if" scenarios, the Commission would note its general interest in how USWC believes a workshop approach, to resolve costing issues, would integrate with other aspects of USWC's Plan in Docket No. 90.12.86. Specifically, the Commission is interested in USWC's response to MCI's above-referenced proposal (MCI Data Response PSC-262-c).

#### Product Proliferation and Anticompetitive Strategic Behavior

36. As background, MCC's Dr. Greer proposed a phased

deregulation process whereby the competitive hypothesis can be tested. During the first two phases, Dr. Greer testified for the need to curb anticompetitive strategic behavior of the dominant firm, adding that product proliferation is the most popular of several anticompetitive strategies. Also as background, the Montana Legislature added the new services section to the MTA in 1991 (HB 610 Section 5 (3)). The new services section permits USWC to file prices for alleged new services on a detariffed basis. The statute sets three general conditions an alleged new service must meet in order for the Commission to find that, in fact, the service is new.

37. First, the Commission requests USWC to address Dr. Greer's anticompetitive strategic behavior concern in the context of USWC's ability to proliferate products under the guise of new services, when in fact the products are not new. Second, the Commission requests USWC to interpret the three general conditions that an alleged new service must meet to indeed qualify as a new service. USWC's interpretations should provide the Commission adequate guidance so that any future service filing can be determined to, indeed, be new.

#### Extended Area Service

38. The Commission has recently received several extended area service inquiries. For example, several recent inquiries involved the communities of Shepherd, Clyde Park, Boulder/Basin, and Brady-Conrad. The Commission requests USWC's testimony on the continued merit of EAS vis-a-vis alternative means of providing service. Some alternatives would include expanded local calling areas as well as MTS.

#### Outstanding Issues From Docket No. 88.1.2

39. In Order No. 5354a, the Commission granted USWC's proposed Late Payment Charge (LPC), as stipulated between USWC and MCC. The Commission approved a LPC of 1% applicable to all billed balances greater than \$25.00 which are not paid by the billing date

shown on the next bill. The Commission also approved several exceptions to the application of the LPC. The Commission directed USWC to provide sufficient data in its next rate case to compute a LPC which would apply to the portions of a bill exceeding \$35.00. The Commission also directed USWC to address several other concerns listed in Finding of Fact (FOF) No. 298 which includes a citation to other issues listed in FOF Nos. 33-36 in Order No. 5354a and FOF 16 in Order No. 5354c. The Commission directs USWC to file testimony addressing these issues.

40. The Commission is also concerned with information provided on a customer's bill and the way in which such information is presented. Specifically, the Commission is concerned that customers are fully aware of the actions USWC would take if a customer failed to make payments for deregulated as opposed to regulated services. The Commission is also concerned that customers would be made fully aware of phone numbers through which customers can reach USWC's service representatives for questions regarding their bills. The Commission directs USWC to address this issue in testimony. The Commission invites other parties to submit testimony regarding the above issues.

Dockets Consolidated with Docket No. 90.12.86

41. The procedural order in this case lists the following dockets as those consolidated with 90.12.86:

- 1.89.8.28, re: Dual Service
- 2.89.8.35, re: Integrated Services Digital Network
- 3.89.9.29, re: Open Network Architecture
- 4.90.5.32, re: Digital Switched Service

Of these dockets, the Commission directs USWC to file testimony addressing the below listed issues for items 2 and 3. The Commission's rationale for requesting testimony on these dockets and the issues involved follow.

42. Docket No. 89.8.35, ISDN. ISDN provides a means for a

customer to integrate voice and data transmissions over a single copper wire pair. The Commission granted interim approval of USWC's ISDN tariff which features unbundled access facilities and case-by-case pricing for ISDN features. USWC's tariff states that it would file any contract for ISDN for Commission approval. Order No. 5468 notes that USWC stated that case-by-case pricing was required since costs would vary by customer. USWC did not include any costs in its initial filing.

43. Through discovery in Docket No. 90.12.86, USWC provided a cost study for one of its ISDN customers (USWC RDR PSC-118 (proprietary)). The information provided appears cryptic regarding the services each price and cost represents. The Commission directs USWC to file testimony supporting the cost approach USWC would use for ISDN services it would typically provide in Montana. Included in this testimony, USWC is required to support the cost and pricing methods it would use if it were to provide ISDN service to an hypothetical Montana customer. Other related topics follow.

44. First, FOF 5 in Order No. 5468 states that "USWC argues that introducing ISDN to large customers at this time will allow ISDN to reach its full potential and ensure the ISDN will be available to smaller customers in the future." The Commission directs USWC to explain what the full potential for ISDN is, how smaller customers would benefit from ISDN, and the level of large customer ISDN subscription that would be necessary before it would be cost-effective for USWC to provide ISDN to its smaller customers. Second, the Commission directs USWC to address the assurances the Commission would have that ISDN services would not be subsidized by other services. USWC does not appear to have filed testimony regarding these issues in this docket.

45. The Commission is also concerned with the relationship ISDN would play with the role of service provisions in the future. The legislature declared the policy behind of the Montana Telecommunications Act (MTA), in part, was to "...maintain universal availability of basic telecommunications service at affordable rates" while encouraging competition in the

telecommunications industry. (Sec. 69-3-802, MCA) The Commission is concerned with how the definition of universal service may change in the future. More specifically, how does USWC foresee the definition of basic service which would fall under the umbrella of universally provided service encompass ISDN and/or other services? Additionally, how does USWC foresee the evolution of plain-old-telephone service (POTS) with its modernization program? Would POTS, which may now be defined as single or multi-party rotary service, evolve into purely single-party touchtone service? The Commission, therefore, directs USWC and invites other parties to file testimony addressing how the definition of basic, universally provided service may change in the future. USWC is encouraged to address this issue over a time frame that exceeds the limits of its proposed five-year AFOR plan.

46. Docket No. 89.9.29, ONA. In Docket No. 89.9.29 the Commission granted interim approval of six custom calling features USWC identified as Open Network Architecture (ONA) services since USWC did not have an acceptable costs in place (see Order No. 5467, FOF 8). USWC maintained that ONA services should not subsidize local exchange service nor should the cost of local exchange services be impacted by ONA services (Id, FOF 5). The Commission directs USWC to substantiate these claims with empirical evidence and a review of its ONA pricing methods. This would include a examination of ONA type services which USWC may consider as Non-ONA depending on the customer classes to which these services are provided. The Commission directs USWC to outline and justify its marketing and pricing strategies for ONA services, including a projection of the dates upon which it intends to make its various ONA services available in each of its exchanges. Additionally, the Commission directs USWC to justify its application of market-based pricing for ONA services. Although USWC filed testimony regarding basic and non-basic services, it does not appear to have filed testimony addressing ONA as a sperate issue.

47. A related issue regards the distinction USWC would make between a service it would provide as an ONA and as a non-ONA. This issue regards the way in which USWC may label, described or



market a service which may provide different utility to different customers but would be functionally the same for all customers. For instance, consider a possible comparison if a service were provided to an enhanced service provider (ESP) and was considered non-basic, yet the same service was provided as a basic exchange service. Should the service provided to the ESP be subject to the same regulatory status as the service provided as a local exchange service? Also, would value of service, repackaging, and/or functional equivalency standards allow USWC to detariff a service provided to one customer class (ESPs, for instance) yet allow the same service to be labeled, described, or packaged differently, to be tariffed for another class? The Commission directs USWC and invites other parties to address the above issues in testimony.

#### Previous Forbearance Filings

48. In response to DR PSC-8, 120, and 196, USWC provided certain information regarding the customers USWC serves under forbearance contracts. One of these responses includes some proprietary information USWC uses to set forbearance contract prices for toll services. The information provided does not, however, appear to include analysis showing that any of USWC's currently contracted forbearance prices cover costs. Recent Commission orders approving forbearance filings specifically state the Commission would examine the cost/price relationship for negotiated forbearance contract prices (see, e.g., FOF 5, Order No. 5481). The Commission directs USWC to show that the prices for the services in its forbearance contracts cover all relevant costs. Further, USWC must define what it considers to be the relevant costs for services rendered through these contracts.

#### Cost of Service (COS) Issues

49. In this case USWC filed several COS studies. These studies can be categorized as usage and non-usage and recurring and non-recurring related studies. USWC computed usage costs for services such as MTS, WATS, and Switched Access using its Regional Integrated Network Cost Analysis Program (RINCAP) (Rach-Santos De

La Rosa, Direct, pp. 7-8). USWC computed costs for services with usage beyond a normal telephone call were performed for services such as Custom Calling and TeleChoice using its Switching Cost Model (SCM) (Id.). The Commission has several concerns regarding the methods and data USWC employed to compute costs using its RINCAP and SCM models. USWC is directed to file testimony addressing these concerns as stated below and in Proprietary Appendix A of this order.

50. First, Dr. Bowman states that USWC uses the capacity cost concept (CCC) in its cost models (Bowman direct, pp. 18-19). Dr. Emmerson states that this method proxies long-run incremental costs for "lumpy investments and shared resources" provided that several assumptions are met as listed in his direct testimony, p. 26. Further, Dr. Emmerson lists two conditions which must be met in order for capacity costing approach to be useful. Dr. Emmerson maintains that "...forecast demand ... must outgrow the existing capacity prior to planned replacement for technological or other non-use related reasons" and "...changes in demand must be of sufficient duration to affect future component placements." (Emmerson, Direct, p. 27). Based on these assumptions, the Commission is concerned as to whether USWC's application of the CCC is appropriate for computing costs for services offered in Montana. Specifically, would USWC's cost methods produce results reflective of potential changes in market conditions such as market share for competitive services? Also, would USWC's application of the CCC in its cost computations for services offered in or between exchanges where switching or interoffice transport capacities may never be exhausted or in exchanges which experience zero or negative growth in service demands be economically correct? The Commission directs USWC, and invites other parties, to address these concerns.

51. The Commission is also concerned with the specific methods USWC uses to compute costs using its base-case/change-case simulation method in RINCAP as described by Ms. Rach-Santos De La Rosa at pages 11 through 12 and in the work papers supporting the studies performed using RINCAP (see USWC RDR PSC-5). The

Commission is also concerned with some of USWC's data sources it uses to compute its costs in its SCM. Due to the proprietary nature of these issues, the Commission's concerns are discussed in Proprietary Appendix A of this order.

#### Capped Price vs. Fixed Price

52. In its rate proposals, USWC classified telecommunications services as either basic and non-basic. Some of USWC's non-basic services would have fixed prices (for example, Telechoice service) and some would have capped prices (MTS). USWC states that price caps are incentive regulation schemes which allow customers to share benefits and make USWC to be more competitive in today's telecommunication market.

53. At the scheduled work session on October 30, 1991, the Commission directed USWC to address why some of its non-basic services are price-fixed and some are price-capped. The Commission would like to know the standards USWC used to distinguish its non-basic services so that some have capped prices and others have fixed prices.

#### Cost-based vs. Valued-based Pricing

54. USWC's non-basic services can be further classified as competitive and non-competitive services. The Commission finds that USWC has different pricing policies for these services. For competitive services, USWC usually proposes prices to fluctuate in response to the competitive market forces (Pierce's Testimony, pp. 5-6). For other services, which are usually considered non-competitive services (for example, Telephone Listing Service and TeleMarque Service), USWC usually proposes to set prices based on value of service (Pierce's Testimony, page 7).

55. The Commission believes that if a non-competitive service is priced at its perceived value, the price will reflect how much a customer is willing to pay. Since USWC has monopoly power in its non-competitive service market, in theory, it can set the price at

the monopoly price and gain monopoly profit. Based on this background, the Commission requests USWC to further address the issue of its general pricing policy. Specifically, the Commission is interested in testimony on how USWC justifies its value-of-service pricing given monopoly power concerns.

DONE AND DATED this 4th day of November, 1991, by a 5 to 0  
vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

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HOWARD L. ELLIS, Chairman

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DANNY OBERG, Vice Chairman

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WALLACE W. "WALLY" MERCER, Commissioner

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JOHN B. DRISCOLL, Commissioner

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BOB ANDERSON, Commissioner

ATTEST:

Ann Peck  
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission  
reconsider this decision. A motion to reconsider must be  
filed within ten (10) days. See 38.2.4806, ARM.